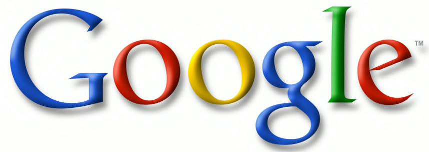

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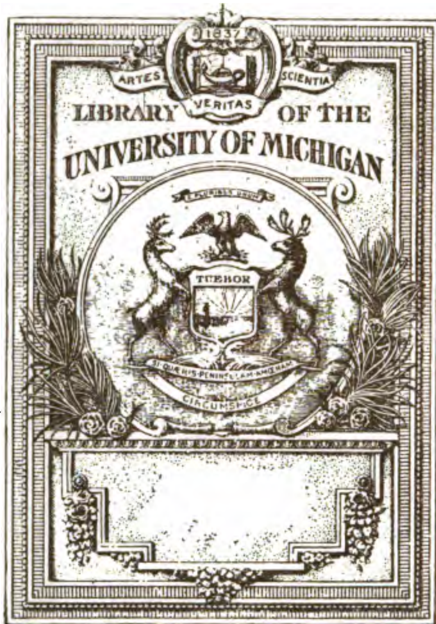
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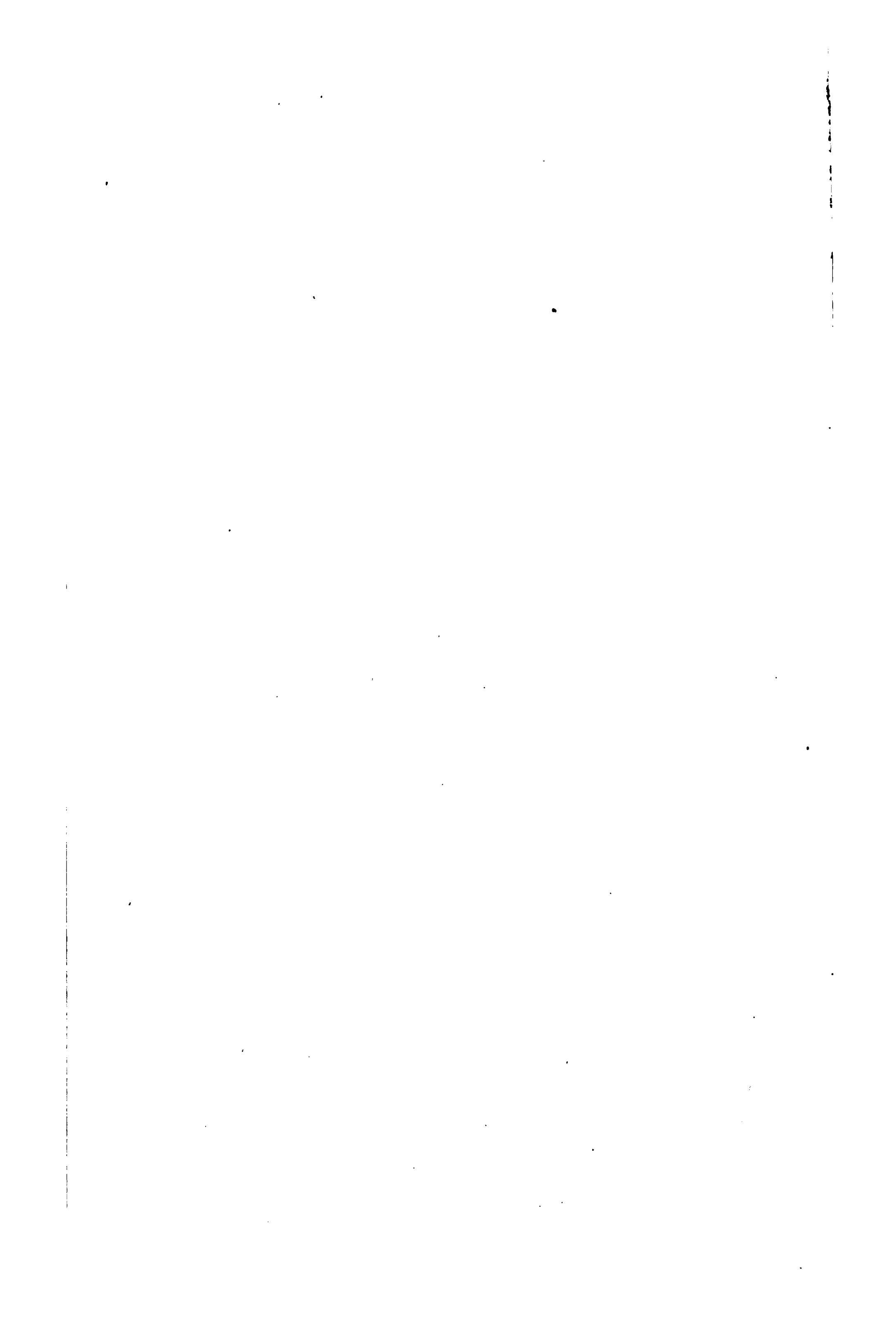


Hart, Schaffner & Marx Prize Essays

XXXII

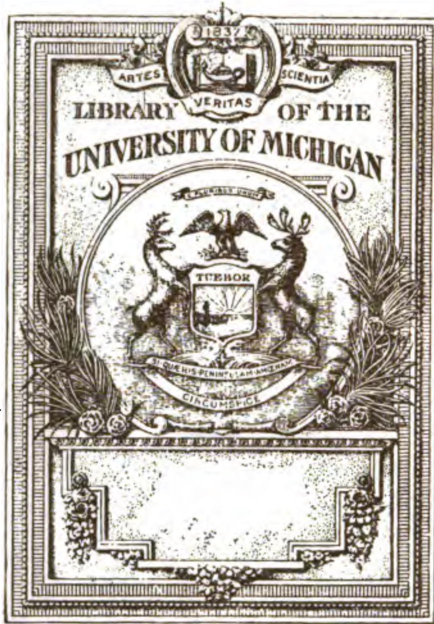
THE GUARANTY OF BANK DEPOSITS

THE GUARANTY OF BANK DEPOSITS

BY

THOMAS BRUCE ROBB, PH.D.
ASSOCIATE PROFESSOR OF ECONOMICS
UNIVERSITY OF MISSOURI

BOSTON AND NEW YORK
HOUGHTON MIFFLIN COMPANY
The Riverside Press Cambridge
1921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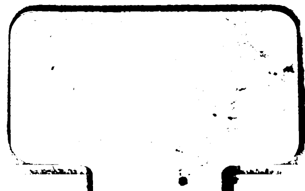

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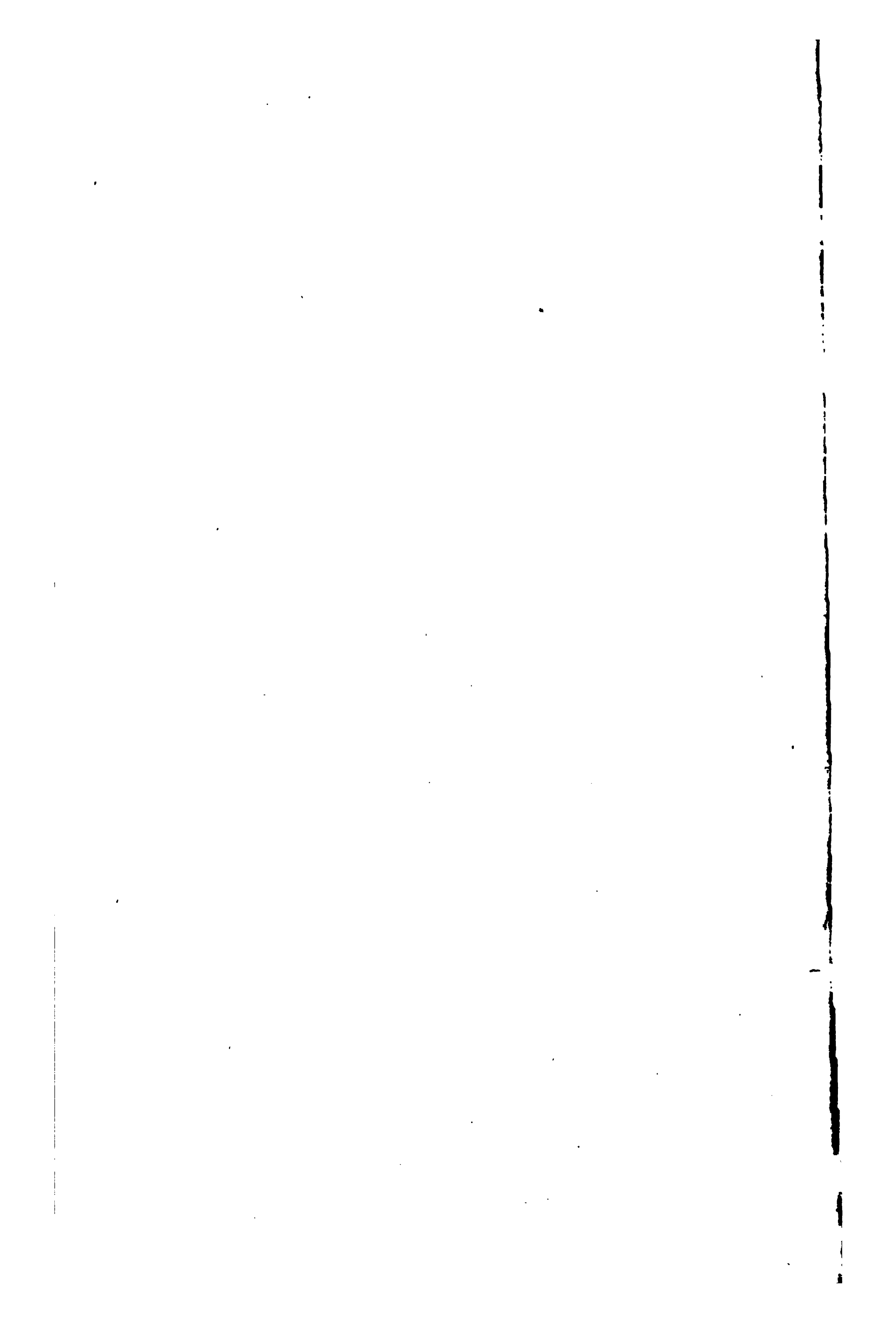

Hart, Schaffner & Marx Prize Essays

XXXII

THE GUARANTY OF BANK DEPOSITS

AUTHOR'S PREFACE

THE guaranty of bank deposits is a part of the larger question of the guaranty of bank credit. Bank credit is an elemental thing consisting of purchasing power which a bank manufactures. This credit manifests itself in two forms, namely, bank notes and bank deposits. The first chapter of this essay deals with the nature of bank credit. In this chapter no attempt is made at an exhaustive discussion — the attempt being made simply to show the general nature of this phenomenon and its significance in the modern world. The second chapter deals with the guaranty of bank credit. In this chapter the characteristics of the two forms of bank credit are set forth and a description is given of the safeguards that have been thrown around each. With this broad view of the nature of bank credit and the relationship existing between bank notes and bank deposits, the way is cleared for a better understanding of the strength and the weakness of the foundation upon which bank-deposit guaranty rests.

In succeeding chapters a statement is given of the framework and the operation of the guaranty laws in the various states. The narrative endeavors to present what has occurred in each state. But attention is especially called to the fact that as each state is considered no attempt is made to weigh, in the light of the experience of that state, the much-mooted questions of bank guaranty. The discussion of these questions is deferred to chapter VIII, where the testimony, gathered from all the states, is brought together and collated for the purpose of showing what light is thrown on these issues.

Finally, the reader is warned that this subject is still surcharged with controversial heat. It yet gets "vitriolic attack or sublimated adulation." Time having not yet furnished a perspective, no one can be certain that he is free from that bias which is so fatal to scientific work.

In the preparation of this little book I am deeply obligated to many persons. Most of all am I indebted to Professor Fred R. Fairchild, of Yale University, at whose suggestion the study was begun and whose advice has greatly influenced the general method of development. Professor R. B. Westerfield, of Yale University, has read the entire manuscript and I wish to acknowledge with gratitude his invaluable assistance with every chapter of the book. I am also under special obligation to Mr. Thornton Cooke, president of the Columbia National Bank of Kansas City, Missouri, for reading the manuscript. Mr. Cooke is well known as the closest and safest student of the guaranty movement, and he has given me many suggestions that I have incorporated bodily into the work. Finally, I am indebted to Professors A. B. Adams, Jerome Dowd, and J. R. Cable, of the University of Oklahoma, for going over my work and giving helpful criticism.

THOMAS BRUCE ROBB

June 1, 1920

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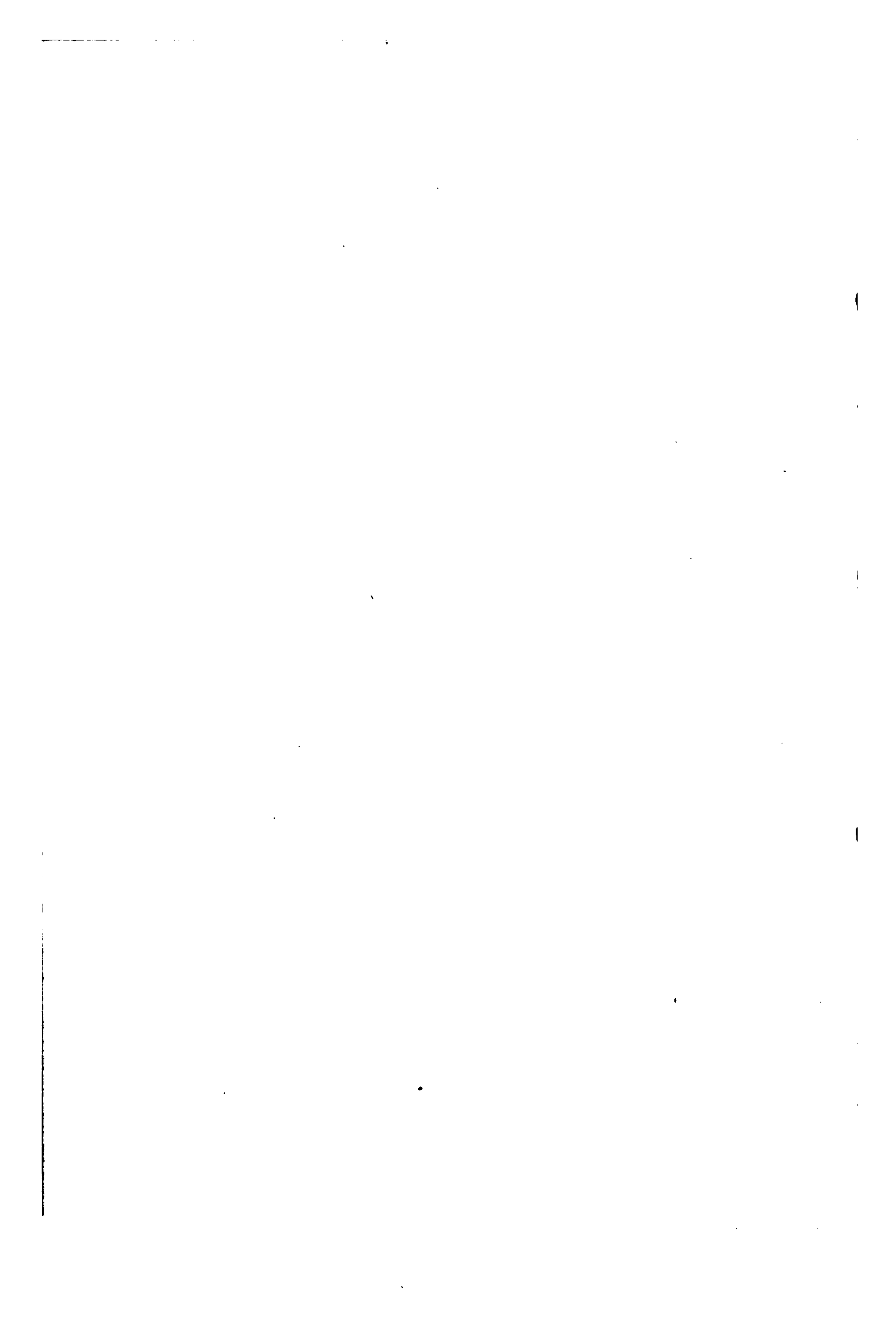


THE GUARANTY OF BANK DEPOSITS

CHAPTER I

THE NATURE OF BANK CREDIT

SOCIETY is best served when its working capital is directed into the hands of those persons best fitted to use it. This is the transcendent service of a bank. A commercial bank collects the temporarily inactive funds of innumerable individuals, and, upon this as a foundation, creates its own superstructure of credit which it places at the disposal of other individuals seeking short-term loans. These lenders and borrowers can get together effectively only through the instrumentality of a bank. Borrowers want substantial sums for certain periods of time; but the surplus capital of a community is in small amounts scattered in many hands. In this shape it is utterly useless to the borrower wanting large sums for stated periods. The commercial bank does much more, however, than simply come between these two parties and bring them together; it marshals these innumerable driblets collected from lenders, and, using them as a basis for its credit, multiplies manyfold the purchasing power that may be placed at the disposal of borrowers. A bank thus not only economizes the capital of a community, but also at the same time performs the inestimable service of selecting those persons best fitted to use it. Society has recognized this service, and the bank, holding its commission in common with other corporations from the government itself, is permitted the profits of the business as a remuneration for its services.

As suggested in the foregoing paragraph, the object of the bank is primarily not to reloan the collected funds, but

rather to use a part of them as a reserve on which to extend its credit. This reserve, of course, is not the real basis of bank credit, but because of legal requirements it serves rather as a limit to the credit-manufacturing process. The bank makes its credit greatly enlarge the efficiency of capital; but by skillful banking it is able to make one dollar in its reserve support many dollars in credit. In this way it greatly increases its loans and so its profits and at the same time multiplies the productive forces of the community. Thus a bank is commonly described as a manufacturer of credit. Macleod says that the mystery and confusion of banking is cleared away by simply observing that a bank is merely a shop for the sale of credit.[1] It now remains to show more fully the nature of this bank credit.

> When a customer pays in money to his account with his banker, he cedes the absolute property in the money to the banker and receives in exchange for it a Right of Action, or Credit, or Debt, to demand an equivalent sum of money at any time he pleases, but not the identical money.[2]

As this quotation shows, from the legal point of view the banker gains a property right in his customer's deposit, but the depositor retains the right to draw on demand. The depositor, by putting his money in the bank, admits by implication that he is not going to use it at once; otherwise he would never have deposited it in a bank. The banker finds that daily his depositors are drawing checks against their accounts. But at the same time others are bringing in money and depositing. By actual experience he finds that this inflow and outflow of money practically cancel each other, while his cash account stands almost untouched. "The banker's cash is, therefore," says Macleod, "like a column of gold with a slight ripple on the surface."[3] The banker is quick to see the possibilities of this situation — possibilities greatly enhanced by the modern check system.

[1] *The Theory of Credit*, p. 606. [2] *Ibid.*, p. 594. [3] *Ibid.*, p. 591.

It is evident that in loaning a large part of these accumulated funds there is a source of profit for the bank. But the bank can do even better yet by using such of the funds as are cash as a reserve for the extension of its credit. Farmers, merchants, and manufacturers come to the bank seeking loans. The prospective borrower gives to the bank his note, possibly secured by a mortgage on personal property or other collateral, for the loan. What he really does is to sell this credit instrument to the bank, and the bank, instead of actually giving him money to the amount stipulated, gives him a book credit with the right to draw that amount. This, of course, is a deposit, but instead of being occasioned by the customer depositing money with the bank, it was in fact occasioned by a creation of bank credit which the customer accepted from the bank in lieu of cash when it purchased his note. The bank continues this loaning process until its deposits are, say, five or six times its cash account. Thus an insignificant part of the commercial deposits is created by the deposit of money; the great majority of them is created by the granting of loans. It is patent that if the borrower demanded cash over the counter, the bank's loaning power would soon reach its limit. But in the large majority of cases, especially where large sums are involved, a checking account is much more convenient to the borrower and it is infinitely more profitable to the bank. To the bank the checking system is largely a transfer of the right to draw from one account to another. If the bank cannot effect this operation on its own books, the banks among themselves accomplish it through the clearing-house. In this way the checking system, by economizing the bank's cash account, greatly extends the field of bank credit and thereby enhances the profits of the business.

Such is the manner in which a bank manufactures credit. Back of this credit is a small percentage of cash and the tangible assets of all those persons to whom the bank has

granted loans. The bank draws interest on the individual credit that it has bought, and as it generally exchanges therefor its own credit, it thus in effect draws interest on its own credit and consequently finds the credit-manufacturing process a lucrative business. Since the manufacture of credit is not an expensive process, there is naturally a temptation to extend the operation as far as possible. The question at once arises, how far can this operation go? The answer to the question is found in the nature of the deposit. A deposit is a right to draw on demand and the bank cannot extend its credit transactions beyond the point where it is able to meet them on demand. It is here that the technique of banking appears. Since a banker must hold himself ready to meet his deposit-liabilities on demand, it is evident that he must not permit his assets to get beyond the point where he is able to supply cash. Short-term loans are therefore dear to the heart of the cautious banker and it is his constant concern to keep their dates of maturity well distributed. Thus the banker will find his depositors presenting checks, many of which must be satisfied with cash, but by skillful marshaling of his assets he brings it about that his maturing loans furnish him a stream of money for this purpose.

So much as to the nature of bank credit. It is now possible to see the service a bank performs as an insurer of individual credit.

> The borrower took his own credit to the bank and exchanged it at a discount for the credit of the bank, namely a bank deposit. The borrower took to the bank his own promise to pay money; he bore away from the bank the bank's promise to pay money.[1]

The reason the borrower was willing to exchange at a discount his own credit for that of the bank was the fact that the bank's credit enjoyed a wider acceptability. As Professor Fisher says:

[1] Johnson, *Money and Currency*, p. 45.

> Through banking, he who possesses wealth difficult to exchange can create a circulating medium based upon that wealth. He has only to give his note, for which, of course, his property is liable, get in return the right to draw, and lo! his comparatively unexchangeable wealth becomes liquid currency. To put it crudely, deposit-banking is a device for coining into dollars land, stoves, and other wealth not otherwise generally exchangeable.[1]

The bank thus makes a business of studying individual credit and one of its great services to the public is its ability and willingness for a given remuneration to substitute what White calls its well-known credit for the individual's less-known credit.[2] President Hadley calls this operation the insurance of credit:

> It [the bank] may be said to insure credit. If it discounts a three months' note and allows the maker to draw checks upon the sum with which it credits him, it protects the public, which accepts such checks, from the risk of subsequent insolvency on the part of the maker. It is because this insurance is effective that the public will accept checks where it will not accept promissory notes.[3]

Bank credit touches intimately the life of every individual. As civilization becomes more differentiated, the production and distribution of goods on which it rests become more intricate. Bank credit is the unguent which lubricates this ponderous machine by which society is sustained, for "the banking system of the country stands at the center of the market," and "it is the market that holds the center of the industrial field and gives to business, however specialized, its unity of purpose." [4] It is evident, therefore, that anything which gives stability to bank credit is at the same time giving stability to the foundations of society itself.

The development of bank credit has proved a great boon

[1] *Elementary Principles of Economics*, p. 173.

[2] *Money and Banking* (5th ed.), p. 202.

[3] *Economics*, p. 245.

[4] H. C. Adams, *Description of Industry*, p. 154.

to mankind, but it is a blessing that cannot be abused with impunity. As already indicated, commercial banks build their credit on a community's deposits. In a sense they become the trustees of this capital, and when this trust is abused either through dishonesty or incompetency, the public is the large sufferer. Dishonest bankers may build up large deposit accounts, make a wrong use of them, and rob the community. Incompetent bankers may be the victims of dishonest and reckless borrowers with the same result. Bank credit, extended to assist in a productive process, is sound and wholesome only when that process ripens into goods which will liquidate the loan. Crop failures, fires, interrupted transportation, and other unforeseen calamities may intervene and upset the best of calculations. The banker, after all, is only a human being, and speculation in its various degrees is his most insidious temptation. This is a situation fraught with great public danger, and nowhere has this danger been greater than in the United States with its adherence to the democratic principle of free banking. Bank notes and bank deposits are the two forms in which bank credit manifests itself, and since the bank as a corporation holds its commission from the government to engage in this business peculiarly affected with a public interest, the government attempts to guard the public from the dangers of these two credit instruments. With this view of the nature, the importance, and the dangers of bank credit, we pass on to a consideration of the safeguards that have been thrown around bank notes and bank deposits.

CHAPTER II

GOVERNMENT GUARANTY OF BANK CREDIT

THE world's representative banking systems are in agreement that note issues must have adequate security. The Bank of England, with a few unimportant exceptions, has a monopoly of note issue. It is permitted to issue up to about $90,000,000 in notes which must be secured by government bonds. Beyond this, notes can be issued only on gold which is held in the vaults of the Issue Department of the Bank.[1] In Canada the notes of the banks are secured by a prior lien on the general assets of the banks plus a five per cent guaranty fund.[2] The Bank of France enjoys a monopoly of note issue which is regulated by the law of Napoleon, namely, that notes must be covered either by coin held by the Bank, or notes secured by collateral and two signatures, or by notes signed by three responsible persons.[3] The German Imperial Bank and other German note-issuing banks are required to hold in their vaults gold or government gold certificates to the amount of one third of their circulation. The balance of their circulation must be covered by discounted notes that bear the names of two good solvent parties.[4] In the United States, under the old national banking system, the national banks alone were permitted, without the burden of a prohibitive tax, the privilege of note issue. These banks were required to purchase United States bonds, and upon depositing them

[1] White, *Money and Banking* (5th ed.), p. 372. Of course this statement regarding the Bank of England as well as the other foreign banks refers to normal pre-war conditions.

[2] *Ibid.*, p. 382.

[3] *Interviews on the Banking Systems of Europe*, National Monetary Commission, p. 195.

[4] *The Reichsbank*, National Monetary Commission, pp. 69–70.

with the United States Treasury were permitted to issue notes upon them. In addition to this a gold deposit equal to five per cent of the note issue must be made with the Treasury. With these bonds and the five per cent redemption fund to protect it, the United States Treasury redeems on demand the bank notes that may be presented. The federal reserve notes, issued under the federal reserve system, are covered by an equal amount of collateral furnished by the member bank desiring these notes. This collateral must also bear the endorsement of the member bank furnishing it. The federal reserve bank issuing the notes must hold back of them a gold reserve of not less than 40 per cent. In addition to this the notes are obligations of the United States Government.[1] Thus the leading governments of the world secure note issues either by the deposit of gold, the deposit of other unquestioned collateral, or by a prior lien on the general assets of the issuing bank. From this it is seen that the universal practice is to guard the note issues so strictly as almost to preclude the possibility of loss to the individual.

As regards deposits, on the other hand, the policy is quite the reverse.[2] In foreign countries governmental regulation is the exception rather than the rule, and the whole matter of reserves, capital, and other banking regulations is left with the banks, working under the law of self-preser-

[1] *The Federal Reserve Act*, section 16.

[2] "Publicity is alone sufficient, in the case of the great monopoly banks of issue, to afford reasonable safeguards against unsound banking and undue reduction of reserves. The cash reserves of these banks, their loans, and their relation to their deposit liabilities are promptly telegraphed around the world and have become a barometer of monetary conditions which is eagerly awaited from week to week in every financial center. They are scanned constantly by the most expert financiers and economic students as well as by business men and officials of the government. Government supervision of the monopoly banks of issue is practically limited to the requirement that these reports shall be made, since the reports themselves afford the evidence that the reserve and the character of securities held are in accordance with the character of the bank." Conant, *The Principles of Money and Banking*, vol. II, pp. 102–03.

vation, to adjust as their needs demand.[1] The United States has gone much farther than foreign countries in this respect, the necessity for this action being well stated by Professor Laughlin:

> Where the business of banking is not a monopoly, but is thrown open to any group of persons who may wish to enter it, that is, under a régime of so-called free banking, there will probably be a few failures from time to time. Under a system where the business is concentrated in a few hands, risks are less and those which exist are met by larger resources. Above all, the best of experience and business judgment is in charge of affairs. There is little more likelihood of the failure of the strong financial institutions of the world, such as the banks of France or England, than there is of the failure of all, or a large proportion of, the banks in the national banking system — an occurrence scarcely more to be anticipated than the breakdown of the whole business community itself. This absolute security, obtainable by committing the business of banking to one or to a few large financial institutions, is sacrificed under a system of free banking like our present one. This is the price paid for freedom of opportunity to engage in the business.[2]

As this quotation indicates, the United States, in her zeal to preserve freedom of opportunity in the banking business, has greatly increased the danger to the depositing public. All through American history this danger has been a very real one. Here almost every section of the country has experienced a phenomenal growth in its day, and the activities of banking have been intimately connected with this rapid expansion. A spirit of optimism and speculation is always present in such boom times, and when the banks become infused with this spirit, the public is exposed to great danger. At times heavy losses have caused much public hardship, and there has been much state interference in behalf of the depositor.

[1] Belgium seems to be an exception to this statement. "In Belgium a reserve of gold and gold bills equivalent to one-third of note issues *plus* deposits is required." Barker, *The Theory of Money*, p. 40.

[2] *Report of the Monetary Commission*, 1898, p. 237.

In this country the law has erected a formidable and complicated system to protect, either directly or indirectly, the depositor. Under the old National Banking Law, the law regulating reserves divided the banks of the country into two groups, namely, the reserve city banks and the country banks. The reserve city banks were divided into two classes. Those in the central reserve cities — New York, Chicago, and St. Louis — were required to keep a reserve equal to twenty-five per cent of their deposits. The banks in the other reserve cities had also to keep a twenty-five per cent reserve, but one half of this might be kept with the central reserve city banks. The country banks had to keep a reserve equal to fifteen per cent of their deposits, but two thirds of this might be deposited with the central reserve or reserve city banks. The new Federal Reserve Act has reduced considerably these percentages, but has centralized the reserves in each reserve district instead of concentrating them in one or two large cities. Much the same reserve regulations for state banks are found in the various states. This complicated reserve requirement is a direct legal safeguard to protect the depositor. Stringent laws regulate the size of loans which may be made to individuals, directors, or other bank officials. National and almost all state governments maintain highly trained corps of bank examiners, who periodically examine the condition of the banks.[1] Publicity of statements is required, so that he who runs may read. In case of failure each stockholder in national banks and in many of the state banks is liable to double the amount of his stockholdings. Professor Laughlin has estimated [2] that the capital, surplus, undi-

[1] "The American system of examination is the most thorough in the world. This has been a natural and almost necessary outgrowth of the fact that the system is the most widely extended and contains the largest number of small independent banks. Safety, therefore, could be less easily secured by reliance upon the action of the banks themselves than in the countries where the number of banks of issue is comparatively limited." Conant, *The Principles of Money and Banking*, vol. II, pp. 104–05.

[2] *Banking Progress*, p. 112.

vided profits, and stockholders' double liability alone constitute a cash insurance fund of forty-five per cent of individual deposits. This fund, in connection with the legal reserve requirements, and other banking regulations, has built up such a bulwark around deposits that, since the establishment of the national banking system, the average annual loss to depositors in national banks has amounted to only one twentieth of one per cent of their deposits.[1]

However, the smallness of this average rate of loss cannot be accepted as a criterion by which to measure the amount of suffering caused to the public from losses occasioned by bank failures. This rate represents only the loss in national banks. Undoubtedly, if a composite rate could be made from the losses occasioned through state banks, it would be much greater. But whatever this rate may be, the fact remains that these losses have not been distributed over this long period of time and among all the depositors of the country in proportion to this average rate, but have fallen at certain times upon certain individuals and communities and have been matters of much serious concern. The fact remains that the government does not give the depositor the same protection which has been given to the note-holder, and the possibility of loss is such a nightmare to the public that a banker's reputation for safe and conservative banking is prized more by him than silver or gold.

One reason for the different policy pursued as to the security for bank notes and for bank deposits is that legislators and the public have regarded the two activities as being essentially different in nature. This confusion is probably due to the different historical development of the two phases of banking. Banks and note issues have always gone together in American history. From early colonial days there was a great scarcity of specie, and it was the crying need of a medium of exchange which prompted the establishment of the first banks in the colonies. The old land

[1] *Report of the Comptroller of the Currency*, 1907, p. 27.

banks of Massachusetts and similar banks in Pennsylvania confined their activities exclusively to the issue of their notes. When the abuse of this power prompted an act of Parliament suppressing the issues, this action was made one of the grievances of the colonies against the British Government. At that time banks issued their credit almost exclusively in the form of bank notes.[1] The fact that these bank notes were a medium of exchange, and that any insecurity in them was fraught with great public danger, early impressed itself upon legislators.

In 1829 the Safety-Fund Banking System was inaugurated in New York State. It provided for a special fund to guarantee all the debts of the banks. The intention of the law was to provide security for note issues. At that date deposit banking was so little developed that the framers of the law apparently overlooked the fact that bank debts might also be occasioned by deposits.[2] It was in the period immediately following the enactment of this law that deposit banking began to assume its modern proportions. In New York between 1836 and 1860 the notes of the banks increased only fifty per cent, while in the same period the deposits increased over seven hundred per cent.[3] The panic of 1837 caused widespread bank failures, and the debts of failed banks were such that the safety-fund system broke down under the strain. The New York legislature then realized that the growth of deposit banking had made "all the debts of the banks" consist of something besides those

[1] "The abuse of banking led, of course, to a condemnation of the forms most in evidence; this accounts for the fact that down to the Civil War statutes regulating the excesses of banking related chiefly to note issues, as if they were the only forms of currency created by banks; while the deposit currency has been wholly ignored. In fact, to the present day in our country, there is a prevalent belief — which has come down to us from the earlier decades and from radically different conditions — that the operations of a bank can be effectively controlled by regulations applied to note issues." J. Laurence Laughlin, *The Principles of Money*, p. 140.

[2] *Safety-Fund Banking System*, National Monetary Commission, pp. 272, 385. Also, Knox, *History of Banking*, p. 409.

[3] *Safety-Fund Banking System*, National Monetary Commission, p. 385.

occasioned by note issues. It immediately amended the law specifying that the fund should cover only losses arising from note issues. The New York legislature seemed to regard note issues and deposits as essentially distinct in nature. It seemed to feel that note issues must be sacredly guarded by law, but that deposits were solely a matter between the individual and the bank. The same philosophy appeared at the creation of the national banking system in 1863. Note issues were so guarded as practically to preclude the possibility of loss, while the safety of deposits was left to depend on the partial security already described.

But this distinction between bank notes and bank deposits has little justification in fact. Writers have repeatedly pointed out the similarity of the two instruments. Says Professor Fisher:

> Besides lending deposit rights, banks may also lend their own notes, called "bank notes." And the principle governing bank notes is the same as the principle governing deposit rights. The holder simply gets a pocketful of bank notes instead of a credit on his bank account. The bank must always be ready to pay, on demand, either the note holders — i.e., to "redeem its notes" — or the depositors, and in either case the bank exchanges a promise for a promise.[1]

Macleod says that "deposits are nothing but bank notes in disguise."[2] Dunbar in the following quotation shows clearly the fundamental identity of these two forms of bank credit:

> A little consideration of the manner in which notes are issued by banks will show that in the bank note we have only another form of liability, differing in appearance, but not in substance, from the liability for deposits. The bank note is the duly certified promise of the bank to pay on demand, adapted for circulation as a convenient substitute for the money which it promises. It is issued by the bank, and can be issued only to such persons as are willing to receive the engagement of the bank in this form

[1] *Elementary Principles of Economics*, pp. 170–71.
[2] *Theory of Credit*, p. 600.

instead of receiving money, or instead of being credited with a deposit. Thus the so-called borrower, who in the first instance has been credited with a deposit and to whom the bank is, therefore, to this extent liable, may prefer to draw the amount in notes of the bank and to use them in making his payments. But in this case it is plain that the liability of the bank is changed only in form; it is still a liability to pay a certain sum of money on demand. . . . The notes issued by a bank are thus a liability distinguishable in form only from its liability for deposits, and the functions of deposit and issue, spoken of at the opening of this chapter, instead of being distinct, as is often assumed, are one in substance.[1]

We have already suggested one of the reasons why depositors have not been given equal protection with the holders of note issues, namely, that legislators, as a rule, have failed to recognize the similarity of the two kinds of liability. The difference in the form of the function has obscured the similarity of the liability. The bank note passes from hand to hand, and acceptance is practically compulsory whether the recipient knows anything of the status of the issuing bank or not. Since the poorer classes relatively have fewer bank accounts, they naturally make more use of bank notes, and these classes least of all are in a position to judge as to the worth of the bank note. On the other hand, it is argued that the depositor chooses his bank and can thus protect himself. The bank check, in contrast to the bank note, has a restricted and temporary circulation and the parties concerned are usually in a position to know as to the circumstances of its issue. Legislators have looked upon note-holders as involuntary creditors, while they have thought of depositors as voluntary creditors. When bank notes get into circulation they stay out for an indefinite time, while a check is presented almost at once for payment. For this reason a bank is more apt to grow careless in its preparation to redeem its note issues. Legislators, profoundly impressed by these differences,

[1] *The Theory and History of Banking*, pp. 17–18.

have felt the necessity of throwing special safeguards around the bank note.

To realize the full significance of the problem of protecting deposit credit, the historical development of bank credit must be kept in the forefront. It is immaterial to the profit of a bank whether it issues its credit in the shape of its notes or in deposits. The convenience and preference of the public is the determining factor as to which is used. In early colonial days a bank's sole activity was in issuing its notes. This was the kind of bank credit most suitable to the time, for the population was widely scattered and many people were living in inaccessible frontier regions. Transportation facilities were poor and communication was extremely slow. The conditions of the time required that each person carry with him sufficient currency to do for considerable periods of time. Bank-note credit adapted itself admirably to this early rural economy. But times changed. Wealth accumulated; population multiplied; and means of communication were revolutionized. As people were drawn closer together, it became unnecessary for each person to carry around on his person such large sums of currency. It now became more convenient to deposit this money in a bank and make payments by check. Thus deposit credit and the bank check proved much more suited to the changed conditions until now bank notes play an insignificant part in the total transactions of the country.

It has already been indicated that in New York State the note issues of banks increased only fifty per cent between 1836 and 1860, while in the same time the deposits increased over seven hundred per cent. Dunbar says that it was not until 1855 that the deposits of the banks of the country, taken in their aggregate, rose above their note issues.[1] Since then the growth of deposit credit has gone on apace. In 1918 the individual deposits in all banks in

[1] *Quarterly Journal of Economics*, 1886, 1:405.

the United States amounted to $27,808,472,756.[1] Of these deposits $12,116,364,158 were subject to check.[2] The checks which were drawn against these $12,116,364,158 of deposits transacted about ninety-two per cent of the business of the country.[3] Thus it is seen that bank checks drawn upon deposits are the real currency of the country, while bank notes perform only a minor part of the remaining eight per cent of the business transactions. This shows vividly the great revolution which has occurred in the realm of banking. At the beginning of the last century bank notes and specie were the currency of the country; to-day, with the advent of deposit banking, deposit currency lubricates the channels of trade.

When the total bank credit of the country is considered, it is evident that bank notes play a relatively minor part in the economic life of the people. Furthermore, the problem of giving bank notes adequate security has long since been solved. On the other hand, as population becomes denser and communication more rapid, the importance of deposit credit will assume even larger proportions. It is with the stability of this form of bank credit that the public is now most vitally concerned. If proof is needed that the major interest of the public has now been shifted to deposit credit, it lies close at hand. Dunbar, writing more than thirty years ago, said:

> If there is reason for demanding that the currency used in the small transactions of the community shall be secure, there is also reason for requiring that the greater currency used in the large transactions shall be secure.[4]

Professor Seligman a few years ago said:

> A banking system is not safe when it breaks down under the first strain. When bank notes so far exceeded deposits as they

[1] *Report of the Comptroller of the Currency*, 1918, vol. I, p. 120. [2] *Ibid.*.

[3] Fisher, *The Purchasing Power of Money* (revised ed.), p. 317. See the same work, pp. 491–92, for a comparison of these figures with those of Professor Kinley's investigation on the same subject.

[4] *Quarterly Journal of Economics*, 1886, 1:417.

did fifty years ago, it might have been excusable to think that the safety of the note-holder meant the safety of the business community; but nowadays the test of safety has been shifted from notes to deposits, and our system provides no safety for the latter.[1]

In speaking of the partial security of deposits already described, Professor Taussig says:

> The cause of this remarkable extension of state interference is to be found partly in the early development and wonderful spread of deposit banking, but still more in an underlying dim consciousness that here was really a most important and far-reaching part of the circulating medium. Once the system is fully established, no individual can keep out of it. It is indispensable that he have his bank of deposit and his bank account. And though he may choose his own bank, and may be supposed to be on the watch as to its character and solvency, his means of getting information are necessarily uncertain. The public concern in banking, which at first was chiefly for the security of notes, has come to be no less for their equally pervasive and far more powerful successors, the deposits.[2]

It is easy enough to show the magnitude and the importance of deposit credit, but it is the proportions of this phenomenon that make legislation so difficult. Note issues are only a small part of the total liabilities of a bank. Consequently it is a comparatively simple matter for each bank to set aside special securities for them. The magnitude of deposits is manyfold that of note issues. Note issues during the World War have been expanded faster relatively than deposits; consequently it is impossible to give any stable ratio that the one bears to the other. During this war the individual deposits averaged from fifteen to twenty times the note issues of all banks, and before the recent remarkable expansion of bank credit by means of the issue of federal reserve notes, the relative importance of deposits was even greater. Since a bank's liabilities can be secured only

[1] *The Outlook*, 1911, 99:1056.
[2] *Principles of Economics* (revised ed.), vol. I, p. 388.

by its assets, it is evident that relatively no such fund is available to secure deposits. Legislators, obsessed with the importance of note issues, have given them a prior lien on certain of the bank's assets and to that extent further weakened the security for deposits. Double liability of stockholders is wholly inadequate to give deposits full security, for frequently the deposits of a bank equal twenty-five times its capital stock. Capital, surplus, reserves, etc., are a wholesome check on unsafe banking, but modern deposit credit is pyramided to such a height above this foundation that the only ultimate safety depends on the nature of the security accepted by a bank in exchange for its loans. But here is a wide margin of uncertainty. Flaws in human character, the fallibility of human judgment, as well as the unpredictable behavior of the great forces of nature, render the deposits of all banks more or less insecure. Consequently no one bank, acting alone, can give to its deposits a security like that given to its note issues.

But, while no one bank can give anything near an absolute security for its deposits, the banks working together can give such a security. This, of course, is the familiar principle of insurance. Because of the aleatory element in life, every individual is confronted with certain great uncertainties. The individual, working alone, is helpless in providing effective guaranties against these uncertainties. But an insurance company, assembling a large number of these cases, is enabled through the law of averages to reduce these individual uncertainties to a common certainty. Thus an individual, in union with his fellowmen, can provide adequate security against many of the vicissitudes of life. So with a bank. While no one bank by itself can give its deposits absolute protection, a large number of banks through the magic of foresight and coöperation can easily accomplish this end. Eight states have laws — called bank-guaranty laws in those states — providing for the

insurance of bank deposits. The purpose of the remainder of this essay is to give an account of this banking experiment. A history of the laws will be given, including a description of the laws, their manner of working, and their effects. These bank-guaranty laws have gone a step beyond the traditional policy of banking regulation, and we are now in a position to observe them in actual operation.

CHAPTER III

THE OKLAHOMA SYSTEM

1. *Conditions antecedent to the guaranty law.* It is now more than twelve years since the State of Oklahoma placed a bank-deposit guaranty law upon her statute books. The enactment of this law marked the beginning of a remarkable movement which, within nine years, placed similar laws upon the statute books of Kansas, Nebraska, Texas, South Dakota, Mississippi, Washington, and North Dakota, and powerfully influenced many other states.

The Safety-Fund Banking Law of 1829 was the first application of the bank-guaranty idea in this country. But, as already pointed out, deposit guaranty was not intended to be a part of the scheme and it was abandoned after the panic of 1837. This experiment seems to have been forgotten, and it is doubtful if it had any connection whatever with the revival of the idea in the West nearly a century later. There is record of a few scattered attempts of associated banks to insure mutually their deposits. In Georgia and Florida there is a group of about a hundred banks which has a Mutual Depositors' Guaranty Fund to protect deposits,[1] but such attempts have attracted little attention. Bank-deposit guaranty as we know it to-day seems to have been associated with the Populist movement of the west-central states. In Nebraska during Populist days there was continual agitation, and at one session of the legislature a serious attempt was made to pass a bank-guaranty law.[2] John W. Breidenthal, a Populist bank commissioner of Kansas, urged such a law in his Report of September 1, 1898.[3] Governor Leedy, a Populist governor

[1] *The Review of Reviews*, 1908, 37:340.

[2] *Quarterly Journal of Economics*, 1909, 24:355.

[3] *Fourth Biennial Report of the State Bank Commissioner*, pp. xvi–xxi.

of Kansas, called a special session of the legislature, and the bill that was presented passed the State Senate and lacked only four votes of passing the House of Representatives.[1]

The cause of this early agitation is not far to seek. In the strongholds of Populism the days of the protracted depression of 1893 were especially trying times. One crop failure had followed another in rapid succession. Many of the assets of the banks were in the form of boom paper held over from the years 1886 and 1887. The serious crop failures soon squeezed the inflated values out of this paper with the result that almost every other bank found itself practically insolvent. The numerous bank failures of this period worked incalculable hardship, and the Populist bank-guaranty agitation was the reflection of this distress. In 1897 a turn for the better came. A series of bountiful crops, in conjunction with other favorable conditions, was a boon to that section of the country. By 1900 the whole country was well launched on the upward swing of a modest boom and the Populist movement and the bank-guaranty agitation went out together.

The next time we hear of the bank-guaranty idea was when the Oklahoma Constitutional Convention met in the fall of 1906.[2] A hard fight was made to get into the constitution a provision guaranteeing bank deposits. Judge J. T. Dickerson, of Edmond, Oklahoma, read a paper before the banking committee urging such a provision. Dickerson was a Republican and had been through the fight in Kansas in Populist days. Charles N. Haskell, afterwards governor, and the father of the Oklahoma law, urged the banking committee to act favorably on the proposition, his argument being: "We want this constitution adopted by the people." The proposal, however, had some strong

[1] *The Topeka Daily Capital*, September 5, 1909.

[2] The material for this paragraph was gathered from a conversation with a member of the banking committee of the Oklahoma Constitutional Convention.

opponents on the committee. It was urged that the proposition, being of legislative character, should not go into the constitution which was already too long. When the opponents of the idea found they controlled a majority of the committee, they brought the proposition before the whole banking committee and rejected it by a vote of seven to six. Thus the bank-guaranty proposal, quashed in committee, never came before the whole convention and for the time being was forgotten.

The events leading up to the enactment of the law guaranteeing bank deposits in Oklahoma are well described by A. Piatt Andrew:

> The idea was born in Oklahoma in the very throes of the panic of 1907, after the shortest possible period of gestation. The panic, it will be remembered, began October 28, 1907, and it was not until three weeks later, on November 16, that Oklahoma became a state, and that its first legislature began its sessions. Nevertheless the panic was not yet over; currency was still at a premium and clearing-house certificates were still outstanding throughout the country when the Oklahoma legislature passed its famous law. This first legislature of a new state had been in session only four weeks when, on December 17, it adopted with scarcely any debate a law without precedent in any other country, and with but one dimly remembered, unsuccessful precedent in the United States — a law which nevertheless presented what was probably the most far-reaching and drastic experiment in banking legislation that had been made anywhere in the world for at least two generations.[1]

The first law passed by the initial legislature of this new state was Oklahoma's "Jim Crow law." After disposing of this vexed question the legislature plunged into the consideration of bank guaranty. A week after the admission of the new state to the Union the executive committee of the Oklahoma and Indian Territory Bankers' Association met in Guthrie to consider measures for the relief of the then existing money stringency. This committee drafted

[1] *Yale Review*, July, 1913, pp. 599–600.

resolutions memorializing Congress for relief, the first measure urged being a plan for the guaranty of bank deposits outlined by United States Senator Robert L. Owen.[1] The panic was at its height when Governor Haskell was preparing his message. He strongly urged the passage of a guaranty law and even went so far as to outline the provisions of the bill he had in mind. The bill was introduced in the House December 5, 1907, and passed December 13. Four days later it passed the Senate and almost immediately received the approval of the governor. The law was to take effect in sixty days. During its swift and harmonious passage through the legislature, little patience was manifested in either house with attempts to amend the bill. The only record of any debate on the bill is where the press reports state that the House in agreeing to a Senate amendment debated for an hour the proposition of substituting the word "active" for "acting" in a certain clause.[2]

The motive which prompted the enactment of the law was economic rather than political. With the exception of Governor Haskell, no one person or group of persons was especially prominent in the movement. The Democratic Party happened to be in control of the state machinery and it assumed responsibility for the new law.[3] The panic was a painful reality. Panics are caused by a lack of confidence. If deposits were absolutely safe there would be no lack of confidence; therefore guarantee deposits. Such was the easy and alluring logic which prompted the enact-

[1] *The Guthrie Daily Leader*, November 26, 1907, p. 1.

[2] *The Daily Oklahoman*, December 17, 1907, p. 1.

[3] *The Oklahoma State Capital*, a staunch Republican paper, said editorially the day after the enactment of the law: "The Williams-Roddie bill, an act creating a state banking department and establishing a depositors' guaranty fund, taken up as an emergency bill, is a very needful law and will doubtless do much to allay the financial embarrassment in Oklahoma." Three days later the same paper said: "The law throughout is a very satisfactory one to both depositors and bankers and will help very materially in bringing about perfect confidence."

ment of the law. On the face of it, this was plausible, and the average citizen accepted the idea unhesitatingly. But the proposition soon got into politics. The country was on the eve of a national election. Public approval of the idea had been so spontaneous that no local party organization dared to antagonize it. In 1909 Kansas and South Dakota adopted bank-guaranty laws, the Republicans of those states being responsible for the measures. Early in the same year Nebraska enacted such a law and a few months later Texas followed suit. In the last two states the Democratic Party was in power when the laws were adopted.

2. *Experimental legislation and the frontier.* Here we must pause for a word as to why a nascent state like Oklahoma should or could rush so cavalierly into a movement of this kind. "Oklahoma," says James Bryce, "into which settlers have swarmed from all parts of the Northwest as well as the Southwest, is preëminently the land of sanguine radicalism and experimental legislation."[1] Legislative temerity seems to be endemic to frontier people. Witness the Granger movement of the eighties and some years later the "surprising ease and swiftness" of the rise of the Populist Party calling for the doubling of the currency, government ownership of railroads, and other such ambitious proposals. It is probable that the explanation of this well-known phenomenon is to be found in the fact that a process of selection brings about on the frontier a homogeneous group of persons who have accumulated little of this world's goods. Consequently, when the times become out of joint radicalism has no restraint, for these persons have "nothing to lose but their chains." With the passage of years and the development of natural resources wealth accumulates, and there comes into being a class which, because of a zeal to conserve its accumulations, has little

[1] *The American Commonwealth* (revised ed.), vol. II, pp. 315–16.

to gain and very much to lose through political experimentation. The very fact that people are on the frontier shows that they were restive under the restraints and conventions of older civilizations; and Oklahoma was the last frontier.[1] "There are those who are forever tugging at the leashes of ordered life, eager to venture into the unknown. Forsaking beaten paths, they plunge into the wilderness. They must be always on the frontier of human endeavor, submitting what is old and accepted to conditions that are new and untried. The frontier is thus the seed plot where new forms of life, whether of institutions or types of thought, are germinated, the condition of all progress being in a sense a return to the primitive." [2] A great faith in governmental activity is a well-known trait of the American character, and in this respect the frontiersman is probably most typically American. "The doctrine of equality is unquestioned there, and that governments exist for the purpose of securing it is the common belief. 'A Law Against It' is the specific for every malady."[3] When an idea takes hold of some one it soon sweeps the plains, for, as Bryce said of the American people: "They seem all to take flame at

[1] The following editorial comment on the new bank-guaranty law by the *Guthrie Daily Leader* of December 18, 1907, is of interest in this connection. It said: "Governor Haskell has made history. He arose to the occasion when the people needed action. Without hesitancy, knowing full well that failure meant political ruin, he bridged the awful chasm between prosperity and calamity, tearing loose from all ancient and useless customs, Oklahoma, thanks to a militant chief executive, steps to the fore in the banking world, and says not only to her own, but to all other people that she will pledge her great, boundless, and widely diversified resources to the protection and safety of their savings. Above the comprehension of the petty partisans, the act will be the star of guidance for ages to come, and proclaimed by the historian as an act of statesmanship undreamed of a year before its adoption as law. Whilst the old régime was wailing and pleading for a wild-cat, elastic currency, begging from the very Federal Government, Oklahoma, through her native resources, solved a financial problem that was ages old, and no other state will long dare refuse to follow in the procession."

[2] C. L. Becker, *Turner Essays in American History*, p. 88; cf. also M. S. Wildman, *Money Inflation in the United States*.

[3] C. L. Becker, *Ibid.*, p. 104.

once, because what has told upon one has told in the same way upon all the rest, and the obstructing and separating barriers which exist in Europe scarcely exist here." [1] This helps to explain why Oklahoma rushed into legislation on this difficult question with a rapidity which almost took the breath away from older sections of the country.

The people of Oklahoma had a definite and immediate aim in view and to accomplish it they invoked the aid of legislation. But as it turned out, the thing was not nearly so simple as it seemed; for, as President Hadley says: "Legislation is essentially a matter of remote consequences." [2] The lapse of over twelve years has made it possible to assess what some of these consequences are.

3. *The law and its amendments.* As originally passed the Oklahoma law was extremely crude and soon radical amendments were found necessary. The law provided that the depositors of failed banks should be paid at once. To create a fund from which to make such payments an assessment was levied against the capital stock of each state bank and trust company equal to one per cent of its average daily deposits.[3] If the average deposits of any bank should be larger for the succeeding year, it was required to pay an assessment equal to one per cent of the increase. No provision was made for keeping the fund. Should the fund become depleted it was to be recouped by means of special assessments and no limit was placed upon the amount of these special assessments.

The amendment of June 11, 1909, made some important changes. It provided that the guaranty fund should consist of five per cent of the average daily deposits instead of

[1] *The American Commonwealth* (revised ed.), vol. II, p. 295.

[2] *Economics*, p. 17.

[3] This original one per cent assessment was collected under the following calls: one half per cent, February 17, 1908; one fifth per cent December 1, 1908; one tenth per cent, September 1, 1908; one fifth per cent, December 31, 1908.

one per cent. The assessment was to be one per cent of deposits the first year and one fourth of one per cent each year thereafter until the five per cent fund was accumulated. The amendment of March 6, 1913, reduced the guaranty fund from five per cent to two per cent of average daily deposits. The amendment of June 11, 1909, limited the extra assessment of any one year to two per cent of average deposits. This removed one of the grave dangers of the law as first constituted, for, originally, there was no limit as to what might be demanded of a bank in case of great losses. The last amendment with regard to assessments provides that the annual assessment shall be one fifth of one per cent of average deposits, and no more. During the years 1914, 1915, and 1916 the state banking board could also levy annually an extra assessment of one fifth of one per cent. As the law now stands one fifth of one per cent is the limit to the regular annual assessment, and special assessments were prohibited after the year 1916.[1] The amendment of June 11, 1909, also provided that in case the guaranty fund and the extra assessments failed at any time to meet the losses, then the state banking board should issue to such unsatisfied depositors certificates of indebtedness bearing six per cent interest. As soon as the legal assessments recouped the guaranty fund these certificates were to be called in and paid.

On the face of it this long rehearsal of amendments and re-amendments may be dull and uninteresting. But through it all can be seen the whole history of the Oklahoma experiment — a history abounding with incident and sordidness. The initial idea was to build up a large cash fund and by means of oppressive regular and special assessments to maintain this fund in the face of the most severe losses. This first idea was gradually given up; the large fund was reduced to a relatively small one; the burdensome assessments gave place to moderately light ones;

[1] *Banking Laws of the State of Oklahoma*, section 46.

and in case of an emergency the banking board obtains cash by the sale of interest-bearing certificates in the open market. Light assessments over a period of years were relied upon ultimately to liquidate these certificates.

So far we have enumerated only those provisions and changes in the law which govern the creation of the guaranty fund. It is necessary further to show how this fund is kept, the composition of the state banking board, and other provisions for the administration of the law.

The amendment of June 11, 1909, provided that seventy-five per cent of the guaranty fund should be invested in state warrants or other such securities, the remainder being held by the state banking board as a ready fund. In 1911 the law was further amended in regard to the custody of the fund. Now the Oklahoma banks pay their assessments to the guaranty fund by means of non-interest-bearing cashiers' checks. These checks are held by the state banking board until needed, thus for the time being giving the bank the use of its own assessment. To secure its liability to the guaranty fund each bank is required to deposit with the banking board bonds or warrants equal to one per cent of its deposits, but not less than five hundred dollars in any instance.[1]

Another vital change which has been made concerns the composition of the state banking board. This board administers the guaranty law and is the custodian of the guaranty fund. The original law provided that the board should consist of the governor, the lieutenant-governor, the president of the board of agriculture, the state treasurer, and the state auditor. As will be seen, the composition of this board was purely political and the evidence seems pretty conclusive that its administration of the law was likewise purely political. When the losses began to threaten the Oklahoma system the banks sought to have the personnel of this board changed. They wanted to re-

[1] *Banking Laws of the State of Oklahoma*, section 48.

move the board from the influence of politics, and, at the same time, get it into the hands of men especially trained for this business. They proposed, therefore, that if the board should be placed in the hands of the bankers themselves, their representatives would serve without pay. This proposal was accepted in the amendment of March 6, 1913, and now the state banking board is composed in the following way. Each state bank has one representative in the State Bankers' Association. This association selects an executive council of not less than nine or more than fifteen members. This council recommends to the governor the names of nine persons from which to select three members of the board. The three persons chosen, together with the bank commissioner and the assistant bank commissioner, constitute the state banking board.[1] The duty of this board is "to keep an account of the collection of the depositors' guaranty fund, showing all collections from assessments and assets of failed banks, and from all other sources, together with the disbursements of said fund and certificates of indebtedness outstanding or other obligations chargeable against the same, and to send each bank operating under the laws of this state a quarterly financial statement showing the exact condition of the depositors' guaranty fund."[2]

In case of insolvency the bank commissioner takes charge of the bank; or, if he is satisfied that the bank is insolvent, he may, after due examination, take possession and liquidate it. The depositors are paid in full out of the available cash. If this is not sufficient the banking board draws upon the guaranty fund, and if necessary makes additional assessments. However, as noted previously, these emergency assessments have ceased since the year 1916. The bank commissioner then proceeds to liquidate the failed bank, and as the assets are realized upon he pays back to

[1] *Banking Laws of the State of Oklahoma*, section 43.
[2] *Ibid.*, section 46.

the guaranty fund what was taken from it to pay depositors. If a special assessment was made this is also paid back.[1] If what is realized from the assets of the failed bank is not sufficient to pay back to the guaranty fund what was taken from it to pay the depositors, then the fund must stand the loss. Should the guaranty fund together with the special assessments be insufficient to pay the depositors of the failed banks, then the banking board is directed by law to issue certificates of indebtedness bearing six per cent interest. At first the board was permitted to issue these only to depositors, but now it may issue them to the public at large, thus borrowing money on the credit of the guaranty fund to pay depositors. These warrants "shall constitute a charge and first lien against the capital stock, surplus, and undivided profits of each and every bank operating under the banking laws of the State of Oklahoma, to the extent of liability of any such bank to the depositors' guaranty fund under the provisions of this act." [2]

The original law covered all deposits, but now deposits otherwise secured are not protected by the fund.[3] No deposit is protected on which a greater rate of interest is paid than that allowed by the bank commissioner.[4] This rate is now placed at four per cent. Trust companies were included by the first law, but in 1911 their deposits were excluded from the protection of the fund. When a bank is organized it must pay three per cent of its capital stock to the guaranty fund. At first this amount was subject to adjustment at the end of the first year on the basis of average daily deposits, but this was later changed and now this three per cent assessment is one of the costs of organizing a new bank. When a bank complies with the law the bank commissioner issues to it a certificate stating that its deposits are guaranteed by the depositors'

[1] *Banking Laws of the State of Oklahoma*, section 63.
[2] *Ibid.*, section 46. [3] *Ibid.*, section 49. [4] *Ibid.*.

guaranty fund of Oklahoma. The bank is allowed to display this certificate in its place of business, but it is not permitted to advertise that its deposits are guaranteed by the State of Oklahoma.[1]

This long delineation of the evolution of the present Oklahoma law gives us an idea of the complete transformation which twelve stormy years of its operation have made imperative. This law has two outstanding characteristics which have been dominant factors in the Oklahoma experience. First, the law is compulsory. All state banks must qualify and come under its provisions. Second, depositors are paid at once. These are the two mooted points in the bank guaranty laws of the seven states, and these two principles are largely responsible for the peculiar working of each system.

4. *Insurance phases of the law.* So far we have spoken of the "guaranty" of bank deposits. But now with the provisions of the Oklahoma law before us, attention should be called to the fact that the scheme is essentially a matter of insurance. It is a compulsory insurance company administered by the state. We must now consider whether bank-deposit insurance is scientific insurance within the meaning of that term as used in the three great branches of insurance, namely, life, fire, and marine. The constant aim of well-administered insurance is to secure a homogeneous group. Such a group is obtained by classifying like risks into their respective classes. The purpose of this is twofold. From the standpoint of administration it is much easier to determine accurately the risk to which a group so selected is subject; from the standpoint of the distribution of the costs and the benefits of the insurance it is infinitely more equitable to the members of the group. Scientific insurance selects risks and charges a different rate for each class of risk. Any human risk can be insured if you have

[1] *Banking Laws of the State of Oklahoma*, section 65.

the data to show what the risk is. We have said that scientific insurance selects risks and makes a different rate for each class.

Bank-deposit insurance in Oklahoma forces all the banks into the company and then charges the same rate to all. Does this violate the requirements of scientific insurance? If so, is it not unsound and consequently doomed to ultimate failure? On the face of it it would seem so. But, while the state forces all banks to join the system, it really does make some selection of risk by means of its rigid supervision of the banks. State supervision is supposed to establish a minimum standard and then charge a uniform rate. If the system is properly administered, certainly bank-deposit insurance is as "scientific" as most of the haphazard guesswork which in the past has determined much of our fire and marine insurance rates. Life insurance is the most scientific insurance we have, and while no two banks were ever created equal, it is also well known that no two lives are an equal risk to the insurance company. The life insurance company by means of a medical examination tries also to establish a minimum requirement at each age, and then by means of its mortality table establishes rates for these different ages based on the average experience. After this is done it permits, for the most part, the insured to govern his own life, relying for its protection on the law of self-preservation. In bank-deposit insurance there is a similar selection made. The state, in its supervision of banking, lays down very definite moral and ethical standards for men who are permitted to engage in the business. This standard may be just as severe as any physical standard a life insurance company may impose. The state has also copious statistics of bank failures from which it can determine the risk involved. Finally, when a bank is chartered, it is not turned loose to run as it will, but by a system of periodic examinations and reports it is kept under the constant surveillance of the state. Since the age ele-

ment is of no consequence in bank-deposit insurance, it would seem, therefore, that it is little less scientific than life insurance itself. Of course, the equity or the desirability of compulsory deposit insurance is another matter.

It is sometimes argued that bank-deposit insurance is doomed to failure because it is assessment insurance. That is, it does not build up a reserve fund which, placed at compound interest, is sufficient to meet each loss as it occurs. Confusion arises here in not recognizing certain vital differences between life and bank-deposit insurance. All the world is acquainted with the wreckage of assessment life insurance companies. Such life insurance companies are disappointments because of the fact of increase of risk with increase in age. The assessments are low when the company is first organized because the risks are at a very favorable stage. As the company grows older the group of lives forming it also increases in age and consequently the assessments mount upward until they become intolerable. The age element does not affect a bank. If anything, the older a bank gets the better risk it should be. It is evident, therefore, that there is no foundation for this fear of assessment bank-deposit insurance.

But bank-deposit insurance does have its drawbacks. With the possible exception of life insurance all insurance has a tendency to relax the vigilance of the party insured. If a house is heavily insured against fire it seems to be human nature that the average man will not exercise the same care as when there is no insurance. For the same reason the average banker, knowing that his customers can suffer no loss, will surely be less careful than he otherwise would be. But even on this score between fire and bank-deposit insurance the advantage is all with the latter. When a man's house burns his house is gone, but he has his insurance; when a bank breaks the banker's depositors are safe, but his stock is worthless and his reputation is gone. It will also have the tendency to destroy the vigi-

lance of the depositor himself. But the ability of the ordinary depositor to judge the solvency of his bank has been greatly exaggerated in public discussions. It is well known that it often takes the trained bank examiner some time to find out the true condition of a bank. To the ordinary depositor the ways of modern banking are past finding out, and he is consequently forced to rely largely on the supervision of the government.

A more serious drawback to bank-deposit insurance is the danger of a concentration of risk. In a state where the economic life and most bank loans of the people rest on an agricultural foundation, a long series of crop failures may cause such a shrinkage in assets as to precipitate serious bank failures. This is the drawback to a state guaranty system. The state lines fence in a restricted area and then a local, intestine disturbance causes a great concentration of risk. This is like a fire insurance company writing too many of its policies in one city or in one block. This objection is of more than theoretical importance, as will be seen when we come to consider the relation of protracted crop failures in that section of the country to Oklahoma's fifty-odd bank failures. A national bank-guaranty system would lessen this danger, for with the diversified economic life of the country an unfavorable experience in one section would tend to be offset by a favorable one in some other.

5. *The law in the courts.* The Oklahoma law as passed in 1907 applied only to state banks, but the national banks operating in the state were permitted to enjoy its privileges on the fulfillment of all the requirements of the law. Since the guaranty idea was popular with the people the national banks felt that unless they entered the system the state banks would have an undue advantage. Consequently by August 1, 1908, fifty-seven national banks had elected to comply with the state law.[1] This movement was stopped

[1] *First Annual Report of the Bank Commissioner*, 1908, p. ix.

on the above date by an opinion handed down by Attorney-General Bonaparte, denying the right of a national bank to take advantage of the law. He held that the Oklahoma law required a bank to guarantee the obligation of a third party, and that this privilege was denied a national bank by the national banking laws.[1] This opinion of the Attorney-General struck terror into the camp of the national banks, and many of them, while not believing in the economic soundness of the law, renounced their national charters and incorporated under the state laws. Deposit guaranty proved so popular with the masses that this movement continued until the great avalanche of bank failures in 1910 and 1911 put an end to it.

The law had scarcely gone into operation before it was required to run the gantlet of the courts. Almost at once the Noble State Bank asked the district court of Logan County for an injunction restraining the state banking board from levying the first assessment. The main contentions of the Noble State Bank were, first, that the state legislature had no power to modify its charter, and, second, that a law requiring it to contribute toward making good the debts of a third party was depriving it of its property without due process of law and therefore unconstitutional. The local court denied the injunction, whereupon the case was appealed to the State Supreme Court. On September 11, 1908, Chief Justice Williams of this court handed down a decision, representing the unanimous opinion of the court, upholding the decision of the lower court.[2] The contention that the legislature had no power to modify the bank's charter harks back to the now famous Dartmouth College case. But Justice Williams showed clearly in his decision that the Indian Territory constitution under which the above bank was chartered contained the provision that "Every grant of corporate power is subject to

[1] *Quarterly Journal of Economics*, 1909, 24:90.
[2] Noble State Bank *v.* Haskell, 22 Oklahoma, 48, 72.

alteration, suspension, or repeal, in the discretion of the legislature," and further that the Oklahoma state constitution under which the bank was then operating, contained substantially the same provision. On the second point, however, the Noble State Bank was not satisfied and at once appealed the case to the United States Supreme Court. Early in January, 1911, Justice Holmes of this court handed down an opinion, which was fully concurred in by all the other judges, upholding the constitutionality of the law. The principal point at issue was that by this law the state took private property of one bank for the private use of another bank without compensation. In the course of his opinion Justice Holmes said:

> The only contract that it [the bank] relies upon is its charter. That is subject to alteration or repeal, as usual, so that the obligation hardly could be said to be impaired by the act of 1907 before us, unless that statute deprives the plaintiff of liberty or property without due process of law. Whether it does so or not is the only question in the case.
>
> In answering that question, we must be cautious about pressing the broad words of the Fourteenth Amendment to a drily logical extreme. Many laws which it would be vain to ask the court to overthrow could be shown, easily enough, to transgress a scholastic interpretation of one or another of the great guaranties in the Bill of Rights. They limit more or less the liberty of the individual, or they diminish property to a certain extent. . . .
>
> The substance of the plaintiff's argument is that the assessment takes private property for private use without compensation. And while we should assume that the plaintiff would retain a reversionary interest in the contribution to the fund, so as to be entitled to a return of what remained of it if the purpose were given up, still there is no denying that by this law a portion of its property might be taken without return, to pay debts of a failing rival in business. Nevertheless, notwithstanding the logical form of the objection, there are more powerful considerations on the other side. In the first place, it is established by a series of cases that an ulterior public advantage may justify a comparatively insignificant taking of private property for what, in its immediate purpose, is a private use. And in the next, it would seem that there may be other cases besides the everyday one of taxation,

in which the share to each party in the benefit of a scheme of mutual protection is sufficient compensation for the correlative burden that it is compelled to assume. At least, if we have a case within the reasonable exercise of the police power as above explained, no more need be said. . . . We cannot say that the public interests to which we have adverted, and others, are not sufficient to warrant the state in taking the whole business of banking under its control. On the contrary, we are of the opinion that it may go on from regulation to prohibition except upon such conditions as it may prescribe. In short, when the Oklahoma legislature declares by implication that free banking is a public danger, and that incorporation, inspection, and the above-described coöperation are necessary safeguards, this court certainly cannot say that it is wrong.[1]

6. *The nature of the banks insured.* The law was to go into effect February 14, 1908. The nature of the risk involved is of prime importance in any matter of insurance. For this reason it is necessary to pause for a moment in order to get before the reader a clear conception of the nature of the banks whose deposits were insured by this law. "The banker and the saloon-keeper were the first men on the spot as a new railroad was pushed forward and a town-site laid out. The banker opened up in a tent with his vest pockets as his safe. He took in money for safekeeping and often charged high rates for keeping his neighbors' money. Sometimes he had men with Winchesters stationed around his place to protect it." Such was the beginning of banking in Oklahoma as described to the writer by an early territorial bank commissioner. From this crude beginning the banking system at the time of statehood was the result of a process of development. The nature and condition of these banks we must examine more closely.

In Indian Territory prior to 1901 no provision was made for banking corporations other than the national banks. In this territory the Five Civilized Tribes were under the

[1] Noble State Bank *v.* Haskell, 219 U.S. 112, 116–17.

control of the Department of the Interior with the result that local government was tribal except where village government was permitted by the Indian agent. With the exception of the national banks, which, of course, operated in both territories, the banking in this territory was of a private nature. A few men would get together and advance a little money, buy a safe and some office furniture, and start business. They borrowed their funds from older banks and reloaned them to local parties at greatly enhanced rates of interest. As time went on they gathered in some local deposits which were loaned at will, for the banks were subject to no more regulation than grocery stores. On February 18, 1901, the President approved an act of Congress which extended the general corporation law of Arkansas to the Indian Territory. Arkansas had nothing to do with the administration of the law, the law being administered by the United States courts. It is probable that the Arkansas law was taken as the two political bodies were contiguous and many of the people of the Indian Territory had come over from Arkansas and were familiar with the Arkansas law. Banks that desired to incorporate did so, those that did not care to do so did not. The banks that were chartered were given no further regulation, and the unorganized banks had also, of course, no regulation. Loans were made in large part on chattel mortgage — that is, on stock, farm implements, crops, etc. Not many loans were placed on real estate for the simple reason that the Indian could not dispose of his land and consequently could not mortgage it. In making loans it was inevitable that these "bankers" must often assume great risk, and men conversant with conditions in those days estimate that the interest rate probably averaged thirty-five per cent. Such was the general banking situation in the Indian Territory for a period immediately preceding statehood.

As regards Oklahoma Territory the situation was somewhat different. In 1889 occurred the first opening of land

in this section of the country, and the following year a territory was organized with its own legislature. The executive officers were appointed by the Federal Government. This territory took its statute law from various sources, but its corporation law was drawn largely from Nebraska. In 1897 a banking law was passed requiring banks to incorporate and placing them under the direction of a commissioner. Many very able and conscientious men served as territorial bank commissioners, but their work was generally crippled for the want of adequate funds. A few facts taken from the Third Biennial Report of this commissioner will show some of the difficulties under which they were laboring. In the two-year period, 1900–02, four different men occupied the office of commissioner. This commissioner had not only to care for the routine of his own office, but also personally to organize the new banks and make all the bank examinations. In these two years one hundred and twenty-four new banks were opened for business, and the funds at the disposal of the commissioner consisted of five hundred dollars with which to cover office rent, office supplies, and traveling expenses. Regarding this condition the commissioner said:

> The banks have been increasing in numbers so rapidly that to visit each one personally and conduct the large correspondence of the department, attend to the opening of the new banks under proper requirements, is rendered a matter of great difficulty, and to give to the business the attention and care it demands and ought to receive is practically out of the question.[1]

Many of these new institutions were anything but strong banks as the following quotation from the bank commissioner will show:

> Under the present state of the law $2500 in actual money is all that is required to open a bank and receive an unlimited amount of money on deposit, and a one-third portion of that grossly in-

[1] *Third Biennial Report of the Territorial Bank Commissioner*, 1900–02, p. 23.

adequate sum may immediately after opening be invested in real estate or fixtures.[1]

We see, therefore, that there was a semblance of banking organization and supervision in Oklahoma Territory before statehood, but the conclusion must not be drawn that banking practices were consonant with those in older states where conditions were more settled and where the state banks were of much larger capitalization and under the direction of a well-organized banking department with a corps of expert bank examiners.

Such was the general situation in the two territories prior to November 16, 1907. Statehood attempted to weld these two incongruous civilizations, and a few weeks later the bank-guaranty law threw a blanket insurance over all the banks. Before the law should go into effect the state banking department deemed it expedient to have an examination of the banks made. This examination is of special interest because to it we can trace the beginning of Oklahoma's tribulation. The state had no machinery for making this examination, so the governor by telephone appointed thirty-one bankers over the state as special examiners.[2] These thirty-one special examiners may have been good bankers, but they were not trained bank examiners, and training is the most important thing in the make-up of an alert and efficient bank examiner. It was rather sophomoric on the part of the state administration to attempt to make an examination in the space of a few days, for it often takes even a trained examiner some time to ascertain the true condition of a bank. Furthermore, being without machinery for the purpose, the examiners had no well-defined standards to guide them. The result was only what might have been expected. Concerning this examination the bank commissioner said:

[1] *Third Biennial Report of the Territorial Bank Commissioner*, 1900–02, pp. 22–23.

[2] *First Annual Report of the Bank Commissioner*, 1908, p. viii.

On account of the unfavorable financial situation at this time it was extremely difficult in many instances to meet every requirement immediately. If the bank was solvent and showed a disposition to comply with the law as promptly as possible, the department endeavored to be fair and give them an opportunity. . . . While a large number of banks were technically not in harmony with every provision of the banking laws, their general condition was such that the department did not feel justified in closing them and upon their promise to correct the objectionable features of their business they were allowed to continue in operation.[1]

But this description of the condition of the banks was far too roseate. It is now well known that a goodly number of banks, especially on the Indian Territory side, were positively insolvent. In 1911 J. C. McClelland, a member of the state banking board, said regarding these banks:

The condition of the banks in the State of Oklahoma at the time the guaranty law went into effect was most deplorable, and there were a number of banks which were allowed to come under the wing of protection of the guaranty fund that should never have been admitted. A great many of these banks have changed hands, and there are still some of these same banks that cause the department more or less anxiety, and are a source of constant care and vigilance.[2]

The plain truth is, the politicians, who at that time completely dominated the banking board, did not have the courage to hew to the line. The ordinary banker is extremely individualistic. In that part of the world he had become used to conducting his business in a certain way. If the proponents of bank guaranty, in forcing this innovation upon him, had also compelled a thorough house-cleaning and thereafter a new order of things, they would have incurred his lasting enmity. And at every turn we must remember that bank guaranty was now in politics. Life insurance companies give the greatest attention to every

[1] *First Annual Report of the Bank Commissioner*, 1908, pp. viii–ix.

[2] *Proceedings of the Fifteenth Annual Convention of the Oklahoma Bankers' Association*, p. 126.

detail of their medical examinations. Oklahoma was in such a hurry to get her new scheme into operation that she overlooked the importance of the medical examination.

7. *Bank failures.* As we have said, the law went into operation February 14, 1908. In its first twelve years of existence it has had a checkered career. Since that date fifty-seven bank failures have occurred, involving a loss of over two and one half million dollars.

The first bank to be closed was the International State Bank of Coalgate, Oklahoma. This was a small bank with deposits of $36,744.93. The state banking board took $24,-843.73 from the guaranty fund, added to it the cash found in the vault, and paid the depositors at once.[1] When the assets of the bank were liquidated they reimbursed the guaranty fund in full. This is not the interesting phase of the failure; in fact, this bank is not listed among the fifty-seven failures. What does interest us is the feeling, quite prevalent in Oklahoma, that the state administration closed this institution for political purposes. The bank was closed May 21, 1908. Dr. L. A. Conner, its president, said regarding the closing:

> I never will believe anything else but that my bank was closed by Bank Commissioner Smock on telephone orders from Governor Haskell for no other purpose than to make a demonstration of the depositors' guaranty law for the National Democratic Convention at Denver.[2]

The fact that the bank paid out dollar for dollar and that it was closed only a few weeks before the Denver convention would seem to lend color to Dr. Conner's charge. However, this Coalgate bank was one of the Indian Territory banks that were technically not in harmony with the law when they came into the system.[3] Furthermore, the

[1] *First Annual Report of the Bank Commissioner*, 1908, pp. xi–xii.
[2] Quoted from a manuscript of V. E. Danner.
[3] *First Annual Report of the Bank Commissioner*, 1908, p. ix.

bank persistently refused to get technically into harmony with the law. On February 6 the bank commissioner ordered all officers' indebtedness and stock loans taken up and a reduction made in the furniture and fixtures account.[1] This the bank refused to do. On May 1, 1908, a special examiner was sent to examine the bank and he reported to the bank commissioner:

> I find the affairs of this bank in anything but good condition. They have not complied with your instructions in any particular. More than two thirds of their paper is past due and a great majority of the active paper has been in existence from one to three years and is plastered all over the back with extensions. They show a loss now and if they continue in the same way they will show further loss.[2]

The bank commissioner again ordered the board to adjust objectionable features. This they were unable to do, and after a few weeks' delay the bank was closed.[3] The tradition still lingers in Oklahoma regarding the so-called *coup* of the state officials in closing this bank for political effect. It seems certain, however, that the bank deserved to be closed. Regardless of whether the administration had an ulterior motive in closing this bank at the time it did, and with such order and celerity, it can only be regretted that later the same summary methods were not used with other banks that proved to be in a much worse condition.

The first and greatest real bank failure in Oklahoma was that of the Columbia Bank and Trust Company of Oklahoma City. This was the largest banking institution in the state, either state or national, and its failure almost wrecked the infant guaranty system. The bank commissioner took charge of this bank September 28, 1909, and began at once to pay depositors as required by law. The growth of this bank deserves careful consideration. On September 23, 1908, its deposits amounted to $365,686.01.

[1] *First Annual Report of the Bank Commissioner*, 1908, p. ix.
[2] *Ibid.*, p. xi. [3] *Ibid.*.

By February 5, 1909, they amounted to $1,111,805.64, and on September 1, 1909, they were $2,806,008.61. Thus in a little over eleven months its deposits had increased by nearly seven hundred per cent.

Our first concern is to show the methods employed by the officers of this bank in building up this deposit account. Mr. James K. Ilsley, who accompanied a committee sent by the State of Wisconsin to study the Oklahoma system, made the following report in regard to the history and the methods of the Columbia Bank and Trust Company:

> A controlling interest in this institution was purchased about January 1, 1909, by W. L. Norton, H. H. Smock, James A. Menefee, and associates. At this time it had less than four hundred thousand dollars of deposits; within seven or eight months these had multiplied more than sevenfold, reaching nearly three million dollars, an unheard-of and startling gain in so short a period. How was this accomplished? Well, in about every way that can be imagined, legitimate and illegitimate. Norton, the president, had been engaged in oil speculation in eastern Oklahoma and gathered in a considerable line of deposits from his friends by promising loans on easy terms; Smock, the vice-president, had been state bank commissioner and had used his acquaintance with country bankers to obtain deposits; Menefee, a stockholder, also state treasurer, deposited large amounts of public funds directly with the Columbia Bank, and in addition distributed deposits among the country banks with a recommendation of the Columbia as a reserve agent and a strong hint that the opening of an account with this bank would be appreciated. Under the law four per cent had been named as the highest rate that state banks could pay on time deposits, but the managers of the Columbia apparently paid any rate up to six per cent and, in some instances, a commission besides. Now all these and other reckless methods were employed to get business, but at all times the guaranty law was worked for all it was worth, and one cannot avoid the conclusion that this was directly responsible for most of the mushroom growth.[1]

The major portion of the deposits of this bank did not come from the Oklahoma City locality. When the Colum-

[1] *Chicago Banker*, February 19, 1910, p. 17.

bia closed, it had deposit accounts aggregating $1,328,-383.79 with one hundred and nineteen country banks.[1] This remarkable deposit account gives an indication of the influence which Mr. Smock and Mr. Menefee exerted with the country banks. The large individual deposit account of the bank was due, to a large extent, to the personal magnetism of Mr. Norton, the president. He had the happy faculty of getting deposits from every one he met. It is said that one day on the train from Kansas City he chanced to fall in with a certain Missouri banker. At the close of their conversation Mr. Norton told his new acquaintance that he was interested in a bank at Bartlesville and one in Tulsa and the president of one in Oklahoma City. The Missouri banker told him he would send him a deposit, and in a few days sent the Columbia $60,000. Of him the Wisconsin committee said:

> Mr. Norton was not a stranger in the state. He had been for something like two years head of the American-National Bank of Bartlesville before his connection with the Columbia Bank and Trust Company. He was a clever, likeable sort of a fellow and enjoyed a reputation of being a good business man. He was a phenomenal business getter, and, it seems, was able to control a considerable amount of deposits from his friends in the Bartlesville region.[2]

On September 28 there was on deposit with the Columbia to the credit of J. A. Menefee, state treasurer, $189,-165.10.[3] It is worthy of note that this was $61,782 in excess of what it was on September 1, twenty-seven days before. The commissioner of the school land department also had on deposit $190,000 when the bank was closed.[4] It is evident, therefore, that the bulk of the deposits of this bank was gathered from sources outside Oklahoma City.

What relation the guaranty law had to the mushroom

[1] *Report of the State Examiner and Inspector*, p. 233.

[2] *Report of Special Committee on Banking*, Wisconsin Legislature, p. 10.

[3] *Report of the State Examiner and Inspector*, p. 217. [4] *Ibid.*.

growth of this bank now remains to be seen. On this point it is extremely difficult to get unbiased evidence and for that reason we quote at length from the report to the Wisconsin legislature made by the Wisconsin committee:

The largest bank in the State of Oklahoma on the 26th day of September, 1909, was the Columbia Bank and Trust Company of Oklahoma City. This bank suspended and was taken over by the banking board on the very day of the arrival of this committee in Oklahoma City, to-wit: the 28th day of September, 1909. Owing to this circumstance the committee was particularly favored in its opportunities to observe the practical working of this law so far as it relates to the winding-up of the affairs of a defunct bank. The committee spent a week at this place in the immediate vicinity of this bank and had ample opportunity to observe the effect of this bank's failure upon the community, to witness the manner in which the process of liquidation of the bank was carried on, to note the effect on the other banks, and to learn the manifest temper of the people with reference to the situation then existing and with reference to their confidence in the guaranty law of that state.

W. L. Norton, who had formerly been president of a national bank at Bartlesville, was president of the Columbia Bank and Trust Company at the time of its failure, and H. H. Smock, former bank commissioner of the State of Oklahoma, was vice-president. They had controlled and managed this bank for a period of eight months prior to its suspension, having with others purchased it from former owners. At the time of its purchase by the gentlemen above named it had deposits around four hundred thousand dollars. During the course of the eight months of their management the deposits reached as high as three million dollars. Naturally the first question arising from this state of facts is, How were these men enabled to secure such a rapid increase in the deposits of the bank? This committee spent no little time in a conscientious effort to locate the reason for this phenomenal growth. Every man who appeared before the committee was there questioned with a view of determining whether this increase in deposits could be attributed to the guaranty law, if not, what the real causes were for the rapid increase of deposits. Men who were violently opposed to the guaranty law and men who enthusiastically favored it were probed on this subject. It was not claimed by any one appearing before the committee that the guaranty law was entirely responsible for this increase of deposits.

Bankers who were bitterly opposed would not say that in their opinion this increase in deposits could be wholly attributed to the guaranty law; on the other hand, it was conceded by those who favored the guaranty law that it did have, without doubt, a certain influence on the securing of these deposits.[1]

As the above quotation indicates, it is difficult to say just how far the guaranty system was responsible for this growth. Governor Haskell himself admitted in his statement before the Wisconsin committee that "probably the bank could not have shown such large gains if it had not been for the guaranty law."[2] Mr. Thornton Cooke, a close student of the question, says that the law was not responsible for the failure, but that it was responsible for the magnitude of it.[3] In Oklahoma City the feeling is quite prevalent that a public indifference to the wild-cat practices of the officials of the Columbia permitted the piling-up of deposits far beyond what such methods could have effected without the cloak of the guaranty law.

Having considered the causes of this bank's growth we turn now to the causes of its failure. The main reason was the fact that the Columbia's president was a member of a clique of plunging oil and real-estate speculators, and the rapidly accumulating deposits of the Columbia were used to lubricate their ventures. It will be recalled that Norton was heavily interested in a national bank in Bartlesville as well as one in Tulsa. These two banks were in the heart of the oil fields and Norton and his associates were financing many of their ventures through them. During the course of the summer preceding the Columbia's failure Norton sold his interests in these two banks and personally guaranteed all the oil paper connected with his enterprises.

About three months before the failure of the Columbia Bank and Trust Company the Interior Department made a ruling that

[1] *Report of Special Committee on Banking*, Wisconsin Legislature, pp. 8–9.

[2] *Chicago Banker*, February 19, 1910, p. 17.

[3] *Quarterly Journal of Economics*, 1909, 24:337.

the royalty on oil should be increased.[1] Simultaneously with this ruling the Standard made a reduction in the price it was paying for oil. This combination sent a shock all through the oil fields that is difficult to appreciate by any one not familiar with the business or the conditions existing.[2]

For some time the Comptroller of the Currency had been suspicious of the oil paper held by the Oklahoma national banks. Alarmed by the conditions in the oil business he sent special examiners into eastern Oklahoma with instructions to charge off suspicious oil paper whether it was due or not. The result was that most of the paper of Norton and his associates was thrown out of the national banks. This paper, ejected from the national banks, now began to appear thick and fast at the Columbia Bank. During August and September over $648,000 of this oil paper was dumped on the Columbia, $175,000 of this amount coming from one bank.[3] When the Columbia failed it had an overdraft account of $189,000, most of these overdrafts being against companies in which W. L. Norton was interested.[4] This strain was more than the resources of the Columbia could stand.

Some of this oil financing will well repay closer scrutiny. No claim is made that the following few illustrative items represent a full list of the oil paper held by this bank. The

[1] That is, on Indian land leases controlled by the Interior Department.

[2] *Sturm's Oklahoma Magazine*, December, 1909, p. 20.

[3] This information was obtained from a conversation with a man whose official duties kept him in close touch with every phase of the Columbia's liquidation. It is understood, of course, that there has been much ill-feeling in connection with the guaranty law in Oklahoma, and for this reason it is impossible to give the names of many prominent business and professional men from whom much of the material for this chapter has been obtained. This should be borne in mind, not only at this point, but throughout the Oklahoma discussion. The danger of using material of this kind is that it is apt to be biased, but the writer has collated with considerable pains the testimony of the persons interviewed and has tried to make use of only such statements as seem well substantiated.

[4] *Sturm's Oklahoma Magazine*, December, 1909, p. 19.

amount and the nature of such paper held will probably never be known, for, as will be seen shortly, practically all the records of the bank were destroyed or stolen, and when large depositors came for their money they were permitted to go through the note-case and select such paper as they wished to offset their account. No records exist of the details of these transactions. However, a batch of the bank's assets was sold to Cobe and McKinnon, a wrecking concern of Chicago, and a copy of this contract was found among the records of the liquidation. From the items of this contract we get a glimpse of the nature of some of this paper. A few of the items are as follows:[1] Leader Oil and Gas Company, $10,400; Roberts Oil Company, $40,000; Exchange Drilling Company, $6020; Lee Oil Company, $6946.15; Conner Oil Company, $1020; Turtle Oil Company, $2000; Twenty-Five Oil Company, $10,000. Some of the other items were: James A. Menefee, a stockholder, and the state treasurer, $11,021.67; Margaret McKinley, a noted speculator of whom we shall hear more later, $5000; William J. Robinson, $10,300; and the Southwest Mortgage Company, $30,000.

It will be illuminating to see who controlled some of these concerns. The president, the vice-president, and the secretary of the Turtle Oil Company were respectively:[2] George W. Walter, W. L. Norton, and V. McFadden; of the Exchange Drilling Company, W. J. Robinson, W. C. Raymond, and V. McFadden. W. J. Robinson, the president of this company, was the maker of the personal note for $10,300 mentioned above. W. C. Raymond, the vice-president of this company, was officially connected with a number of other Norton-McFadden institutions not mentioned here whose paper wrecked other Oklahoma banks.

[1] *Report on the Oklahoma State Guaranty Fund*, Arthur Young & Company, Certified Public Accountants, Kansas City, Missouri, pp. 63–64.

[2] These facts are taken from the articles of incorporation in the office of the secretary of state, and from records in the office of the state corporation commission.

The Twenty-Five Oil Company was an interesting corporation. This concern had three officers, three directors, and three stockholders. The three persons in each case were Homer Needles, George W. Walter, and Mattie Ault. It was capitalized for $25,000, each of the above-enumerated persons holding one share of stock, par value $25. With a paid-in capital of $75, this oil company had borrowed $10,000 from the Columbia Bank and Trust Company. The recurrence of the names of W. L. Norton, V. McFadden, etc., should be noted. This, of course, is not a complete list of the oil paper which the portfolio of the Columbia contained. After all, the sums involved in these cases were not large, but they serve as an indication of the type of men who were getting the Columbia's deposits. It is known that this bank accumulated upwards of $650,000 additional paper of this general nature in the two months prior to its collapse. It would be interesting to know the companies involved and the men who directed them.

Among the uncollected assets were five personal notes of W. L. Norton amounting to $211,563.69.[1] These notes probably represent loans from his bank to assist him in caring for his oil paper when it was thrown out of the national banks. When the bank failed I. M. Putnam, another celebrated Oklahoma plunger, owed the bank $60,520.95.[2] This was two years before Putnam's fall, and being at this time near the meridian of his power, the bank suffered little. We shall hear of Mr. Putnam again, but his name is mentioned here to show the type of men to whom the Columbia was loaning large sums of money.

We shall now turn our attention to the payment of the depositors. The law required that the depositors be paid at once. The situation was most delicate. About $2,800,000 was owed to depositors. When the Columbia closed it

[1] *Report on the Oklahoma State Guaranty Fund*, Arthur Young & Company, Certified Public Accountants, Kansas City, Missouri, p. 52.

[2] *Ibid.*, p. 53.

had about $28,000 in cash and $185,000 in sight exchange. The guaranty fund amounted to about $300,000, $50,000 of which was deposited in the Columbia Bank and Trust Company. Of the remaining $250,000, three fourths of it was deposited in other banks. Governor Haskell, in the capacity of chairman of the banking board, arrived from Guthrie about eight o'clock of the evening before the closing of the bank. A hurried session of the banking board was held at the Lee-Huckins Hotel. Other members of the board told the governor that it was out of the question to think of opening the bank the next morning to pay depositors with the funds on hand. Haskell dramatically informed them that the bank would be opened the next morning at the usual hour. From that moment he was in supreme command. Wherever the narrative refers to an action of the banking board, it will be understood that the board is only a name connoting the will of this remarkable man — a man admired, yet distrusted by many of his friends, feared and hated by his enemies. It must be borne in mind that Haskell was the one person responsible for the law. He had unsuccessfully advocated it before the banking committee of the constitutional convention; when the panic of 1907 broke he earnestly commended it to the first legislature, and even went so far as to outline the plan finally adopted; in the summer of 1908 he went to Denver and was a potent factor in getting the guaranty plank into the Democratic national platform. Now his pet scheme was subjected to its first baptism of fire, and Haskell realized that his own political fortunes and probably those of his party depended on the issue. His first move was to make arrangements with the local telephone company for an open wire to Kansas City and St. Louis for two hours. There he got in touch with certain parties and told them that he must have money. Before morning it is said he raised in this way about $450,000.[1]

[1] See footnote 3 on page 48.

When, on the morning of September 29, 1909, the bank commissioner opened the doors to pay depositors, as required by law, he had probably about half a million in ready funds, plus the assets of the failed bank, of which upwards of a million dollars ultimately proved bad, to meet deposits amounting to over $2,800,000. There could be but one result. Great discrimination was shown in paying depositors. The small depositors were paid first and only banks and other large depositors that could show an urgent need were given any part of their deposits. It will be recalled that the Columbia had accounts with one hundred and nineteen country banks aggregating $1,328,-383.79. These were the depositors that did not get their money at once. When these bankers came in they were allowed to go through the portfolio of the Columbia and select what paper they wanted to offset their claims. When one would get recalcitrant and want cash, he would be taken back into the directors' room and the banking board would say to him: "You can't get your money. This guaranty system is trembling in the balance and you might as well act decently. Go home and carry your account with this bank (defunct) as an asset in your statement and, if necessary, count it as a part of your legal reserve." [1]

The policy of the administration was to present a bold front to the small depositors and thus allay excitement. Advertisements were inserted in the local papers asking the depositors to call and get their money. Instead of closing at three o'clock the bank was kept open until five in the afternoon so as to suit the convenience of the laboring people. Here was the first chance to test the much-heralded talismanic power of bank guaranty to stop bank runs. Again the testimony of the Wisconsin committee is our most unbiased evidence:

[1] Statement as given in conversations with several state bankers who carried balances with the Columbia.

The closing of the bank caused no riffle in the business world of Oklahoma City, the public was not excited, there was no run on any other bank, state or national. Depositors apparently had confidence that they would get their money. They acted in an orderly and well-behaved fashion. They drew their money out of the defunct bank and placed it in other banks. As a matter of fact, at the close of business on the day after the failure, the books of every other bank in the city showed an increase in deposits. While the lobby of the bank was quite well filled with depositors there was no excitement or disorder, and so far as the street was concerned there was nothing to raise the suspicion on the part of any one that he was passing by a bank whose doors had just been closed. No business interests in the city were disturbed, compromised, or embarrassed in any manner.

The committee came in contact with a great many of the people who had money on deposit in the bank; some of whom appeared before the committee, and all gave expression to the sentiment that they were in no particular hurry for their money, that they knew it was safe, and that they would call for it after the rush was over.[1]

The following figures of Oklahoma City banks, somewhat condensed, are taken from "Sturm's Oklahoma Magazine" [2] and throw light on the effect of this failure on the depositing public:

Six national banks had deposits of $7,935,971 on September 29, 1909, and $9,280,951 on November 11. Six state banks had deposits of $1,578,437 on September 29, and $2,493,319 on November 11. This shows that the national banks had an absolute increase of $1,354,930 or 17 per cent, while that for the state banks was $914,882, or over 58 per cent. However, these figures include $370,000 on deposit with the Central State Bank on November 11, an institution organized since the Columbia failure. In this time only about $1,000,000 of individual deposits of the Columbia had been paid, yet the total increase of bank deposits of the city was $2,269,862.

No doubt seasonal changes will do much to explain this increase in deposits, but the fact remains that these figures

[1] *Report of Special Committee on Banking*, Wisconsin Legislature, pp. 11-12.

[2] December, 1909, p. 21.

show that the failure did anything but cause a general distrust of banks. It is also worthy of note that while the state banks relatively gained faster, the great majority of the deposits went into the unguaranteed national banks.

When the Columbia failed an emergency assessment of three fourths of one per cent of average daily deposits for 1908 was levied and this added about $248,000 to the guaranty fund. The banking board also sold certain securities to Cobe and McKinnon for $300,000. On October 30, 1909, one month after the failure, $411,000 of deposits remained unpaid.[1] State deposits and other special deposits were met by the sale of the collateral which secured them.[2] By December 15, 1910, all deposits had been paid in full except $11,256.79, which represented accounts not called for or deposits against which a counter-claim was held.[3]

The bank commissioner opened the bank to pay depositors before attempting to ascertain the extent of the failure. It was later discovered that the loan and discount register, the daily statement book, the cash book, and other important records had disappeared, and these have never been recovered. In fact, the whole liquidation of the Columbia Bank and Trust Company was so hasty and careless that when a report was being prepared in 1911 on the guaranty fund, no satisfactory records of the liquidation could be found, and the examiners were compelled to subpœna witnesses and take oral testimony as to the transactions.[4] In 1912 the state examiner and inspector made a careful report on the liquidation of the Columbia. This report showed that the banking board entered into two contracts with Messrs. Cobe and McKinnon, the wrecking company of Chicago. One contract showed that for a certain enumerated list of securities the above firm was to pay to the banking board $225,000. The contract called for

[1] *Statement of the Bank Commissioner*, October 30, 1909.
[2] *Quarterly Journal of Economics*, 1909, 24:332.
[3] *Second Biennial Report of the Bank Commissioner*, p. vii.
[4] *Commercial and Financial Chronicle*, November 2, 1912, p. 1172.

$71,750 of Bartlesville Light and Water bonds, but the records show that $111,750 were actually delivered. The $40,000 of extra bonds turned over is not accounted for. The report also shows that $35,000 of the $225,000 was never paid. According to the second contract the same firm was to pay $75,000 for a certain list of notes, bonds, and other securities, but of this amount $16,605.22 remains unpaid. Messrs. Cobe and McKinnon claim that they have counter-claims which offset these discrepancies. No one in Oklahoma seems to know the exact status of the case, and since there is no disposition to unearth any skeletons, the matter will probably rest there.

The closing and liquidation of the Columbia was attended with much bitterness between the national banks and the state administration. From the beginning the national banks felt that a state guaranty law worked a gross injustice to them. They believed such a law to be thoroughly unsound, and the fear that it would ruin their business called forth doleful jeremiads regarding the evil days that must of necessity come. When the Columbia went down, they raised the cry, "We told you so." They charged that the Columbia was an "administration" bank, meaning that the administration was in collusion with the whole sordid procedure. A few days before the bank was closed a certain Oklahoma banker told Norton that for $5000 he would "fix" things with Bank Commissioner Young so that the bank would not be closed. The banker got the $5000, but said nothing to the bank commissioner. When this became known it provoked more ugly talk and the public feeling moved the banking board to compel the banker to return the money to the assets of the bank. As the story of the Columbia failure became better known there developed a quarrel daily renewed between Haskell and certain national bankers. The governor issued a daily statement saying that the law was a complete success and abusing the national bankers for attempting to discredit it.

Certain national bankers increased the pressure of their ridicule until Haskell became so irritated that he sent for the worst offenders and called their attention to the fact that there was a state law against discrediting a banking institution by circulating false statements concerning it. The threat had some effect, but the good governor seems to have overlooked the fact that the law referred only to "false" statements.

Soon after the bank closed Attorney-General West on his own initiative began a grand-jury investigation for the purpose of prosecuting Norton and other officials of the bank. Haskell forthwith ordered this investigation stopped. The governor was handling the situation and he demanded that he be allowed to do it in his own way. His excuse for stopping the investigation was that it would have a deleterious effect upon the liquidation of certain assets of the defunct bank. The governor had but one end in view and that was to make this incident a complete triumph for the guaranty law. To accomplish his purpose he was not very particular as to the means employed. He knew that if Norton was sent to the penitentiary the banking board would get only such part of his private fortune as could be legally taken. Haskell chose to shield Norton from prosecution and then strip him for the benefit of the depositors and the state bankers. In the course of the liquidation Norton turned over securities having a nominal value of $1,053,600. The appraised value of these securities was about $565,000,[1] but they were in large part stocks of the most visionary oil and development enterprises which were already in the last stages of bankruptcy.[2] What was

[1] *Report of the State Examiner and Inspector*, p. 217 D.

[2] These securities were as follows: Numerous promissory notes, par value, $240,600.57. Among these notes were those of twelve oil companies, including those named above and others of like nature. There were also numerous individual notes of which Norton was either the maker or the endorser. Stock of the Renfrow Oil and Gas Company, par value, $379,000; bonds of the Bartlesville Water and Light Company, par value, $24,000; real estate in Oklahoma City, known as the W. L. Norton block,

finally realized from this personal wealth of Norton is not known.

But these strong-arm methods of the governor in shielding criminals from prosecution had a more far-reaching effect. Many state bankers seemed to get the idea that they were immune from prosecution. We must remember that more than fifty banks have gone down since the wreck of the Columbia, and some of these failures surpass, if possible, the bank-robbing aspects of the Columbia's history. The story is told in Oklahoma that, shortly after this, one of the state bank examiners told a banker to charge off certain paper which was considered worthless. The story goes that the banker told the examiner to descend to the promised land. Probably this incident does not much exaggerate the lawless attitude of certain Oklahoma bankers for the next two or three years. This Columbia failure cost the other banks of the state $582,283.79.

It would prove both tedious and unprofitable to take up in detail the other fifty-odd failures as we have the Columbia. However, it is necessary to describe some of the typical failures in order to show the various forces working to effect the failures and to watch the guaranty system in operation under divers conditions.

The First State Bank of Kiefer, Oklahoma, failed December 14, 1909, and was taken in charge by A. M. Young, the bank commissioner. This bank closed because of the liquidation of the Farmers' National Bank of Tulsa, the Kiefer bank having a deposit there of $21,000. Forty-four thousand dollars was drawn from the guaranty fund, and with what was realized on the quick assets of the bank the depositors were paid in full in eight days.[1]

$18,000; Henson Oil Company stock, par value, $10,000; Twenty-Five Oil Company stock, par value, $50,000; Military Park Company's first mortgage bonds, $100,000; Military Park Company's note secured by mortgage, $250,000. See *Report of Arthur Young & Company*, Certified Public Accountants, Kansas City, Missouri, p. 49.

[1] *Second Biennial Report of the Bank Commissioner*, p. viii.

On December 31, 1909, the Bank of Ochelata, having deposits of over $50,000, failed and was taken in charge by the bank commissioner. This bank was liquidated through a new institution known as the Oklahoma State Bank. The commissioner agreed to protect the Oklahoma State Bank against loss in assuming the obligations of the failed bank. It was with this bank that the state banking board inaugurated its policy of liquidating a failed bank either through a new institution or another bank located in the same town. This method the commissioner claimed was much more economical, as the banking board need handle only such paper as the new institution was unable to collect or renew satisfactorily. The commissioner pointed out that this method not only required less funds, but also caused less disturbance in the community.[1] On January 25, 1910, the Oklahoma State Bank reported that they were short to the sum of $18,968.48 in collecting on the assets of the Ochelata Bank, and the state banking board then made good this amount from the guaranty fund.[2]

The Oklahoma State Bank of Durant failed April 28, 1910, and the state banking board deposited $25,000 with the Oklahoma State Bank, through which the failed bank liquidated, to protect it from loss.[3] On March 3, 1911, the Bank of Geary closed and was liquidated through the American State Bank of Geary. This failure cost the guaranty fund $23,024.20.[4] The Citizens' Bank of Mountain Park failed April 10, 1911, and was liquidated through the Planters' State Bank of Mountain Park. The banking board took over $25,690 in notes representing fraudulent transactions of the bank officials and had the officials arrested.[5] The Farmers' and Merchants' Bank of Sapulpa failed September 10, 1912, and its liquidation cost the

[1] *Second Biennial Report of the Bank Commissioner*, p. xii.
[2] *Ibid.*, p. ix. [3] *Ibid.*, p. x.
[4] *Third Biennial Report of the Bank Commissioner*, p. xii.
[5] *Ibid.*, p. xiv.

guaranty fund $105,382.95.[1] A member of the state banking board reported this failure as being "the worst mass of filth he had seen in Oklahoma banking." [2] Two of the officers were placed in jail for failure to produce the books.[3] The failure of the Creek Bank and Trust Company of Sapulpa "was a crooked failure and one of the officers was sentenced to the penitentiary." [4] This failure cost the fund $46,418.26.[5] The liquidation of the Bank of Snyder required $18,732.27 to pay depositors, and the failure of the Security State Bank of Sulphur cost the fund $26,556.71.[6]

The Alva Security Bank of Alva cost the fund $86,938.33. This failure was caused by their "attempting to finance railroad deals, town-sites, creameries, etc.; their note-case was several thousand dollars short." [7] The cashier was arrested. The failure of the Bank of Commerce of Alva required $22,955.51 from the guaranty fund to pay depositors. This failure was due to an excessive amount of large loans.[8] The Anadarko State Bank of Anadarko cost the fund $63,213.48. "The failure of this bank was brought about by certain stockholders of the institution using an excessive amount of the funds of the bank to promote their personal interests." [9] The failure of the Bank of Elgin, of Elgin, Oklahoma, represented a loss of $11,351.46, the failure being caused by dishonest management.[10] The failure of the Bank of Garvin, caused by financing speculative propositions and bad loans, cost the fund $58,718.23.[11]

The failure of the Garfield Exchange Bank of Enid is a good example of much that took place in Oklahoma. Two things wrecked this bank — a president who was by nature a promoter rather than a banker, and the real-estate boom

[1] Records in the office of the Bank Commissioner, March 1, 1920.
[2] *Quarterly Journal of Economics*, 1913, 28 : 75.
[3] *Ibid.*. [4] *Ibid.*.
[5] Records in the office of the Bank Commissioner, March 1, 1920.
[6] *Third Biennial Report of the Bank Commissioner*, p. xviii.
[7] *Fourth Biennial Report of the Bank Commissioner*, p. 304.
[8] *Ibid.*, p. 305. [9] *Ibid.*. [10] *Ibid.*, p. 306. [11] *Ibid.*, p. 308.

which Enid in company with many other Oklahoma towns was enjoying at this time. Ferguson, the president of this bank, had the reputation of being a good business man, and not long before had been president of the Oklahoma Bankers' Association. But notwithstanding this reputation he was essentially a plunger. He loaned heavily to persons who were supposed to be good, but took inadequate security. When the boom collapsed and the sequent depression overwhelmed his customers, he was clever enough to unload the mess on to artless purchasers before the crash came. In fact, there seems to be pretty good evidence that Ferguson used the bank to lubricate his own ventures with always the same result, namely, that when the venture turned out well it belonged to Ferguson; when it went wrong it belonged to his bank.

The rehearsal of one of his typical transactions will be illuminating: Ferguson purchased one hundred and sixty acres of land about two miles from Enid and was successful in getting the fair grounds and stock pavilion located on it. This stock pavilion was a magnificent building with accompanying grounds where cattle and other live-stock would be bought and sold. It cost $50,000 and had the facilities for making Enid one of the largest stock-show centers of the country. The promoters sold bonds to the amount of about $32,000, and Ferguson's bank loaned the other $18,000. The whole enterprise was ridiculously out of proportion to the ability of Enid's environs to support such an institution, with the result that it almost at once went into bankruptcy. The building was finally torn down and the salvage sold. Ferguson was sagacious enough to see the gathering storm and sold his bank to one Butler for a dollar and fifty cents on the dollar. Butler had been a country banker with city ambitions, but died soon after gaining control of the bank, with a broken heart, it is said, because of his inability to return the bank to solvency. The bank was in the hands of a clergyman by the name of Horney at

the time it was taken over by the bank commissioner. The bank commissioner induced a new management to take over the bank, agreeing to protect them from loss. In January, 1915, the District Court of Garfield County ordered the bank commissioner to sell certain of the assets of the bank that were in the custody of the court. In conformity with this order notes of the net value of $90,709.71 and overdrafts of the Garfield Bank to the amount of $1879.50 were sold at private sale for $13,319.95.[1] It required $105,570.29 from the guaranty fund to make good the deposits of this bank.

Another failure which will repay examination is that of the Alamo State Bank of Muskogee. This failure cost the guaranty fund $160,910.84. The trouble started with the Oklahoma Trust Company of Muskogee. On January 3, 1910, the Alamo State Bank took over certain assets of the Oklahoma Trust Company, and the general nature of this paper is so similar to much of the paper held by the Columbia Bank and Trust Company that the following samples are given to show what a small clique of conscienceless speculators was doing to Oklahoma banks. It should be remembered that this trouble started with the Oklahoma Trust Company, and this institution should further be remembered because of its connection with the deal whereby another set of disreputable manipulators gained control of and later wrecked the Night and Day Bank of Oklahoma City. This Oklahoma City episode will receive attention in another place.

The following are samples of this paper:[2] Exchange Investment Company, W. L. Norton security, $57,750; Exchange Oil Company, W. L. Norton security, $26,150; Kansas Reduction Company, $11,945; Kentucky and Ohio Oil and Refining Company, $12,778; Landon Invest-

[1] District Court of Garfield County, State of Oklahoma, 1904, *In re* J. D. Lankford.

[2] *Report on the Oklahoma State Guaranty Fund*, Arthur Young & Company, Certified Public Accountants, Kansas City, Missouri, pp. 94–95.

ment Company, W. L. Norton security, $23,757.68; Madison Oil Company, W. L. Norton security, $5432; James A. Menefee and W. L. Norton, $9661.56; W. L. Norton, $87,698; I. M. Putnam, 2200 shares of Putnam City stock security, $7125; Mutual Investment Company, W. L. Norton security, $26,574.60; John E. Tanner, Renfrow Oil stock security, $10,600; W. D. Applebee, Renfrow Oil stock security, $13,184; W. D. Applebee, Southwest Mortgage Company stock security, $5238; L. A. Moran, Southwest Mortgage Company stock security, $5238; C. H. Brown, Southwest Mortgage Company stock security, $5240; C. M. Bradway, Southwest Mortgage Company stock security, $5240; Genesee Chemical Company, $14,720; and J. H. Bradley, Wellsville Oil Company stock security, $4400.

Attention has already been called[1] to the names of W. L. Norton, V. McFadden, W. C. Raymond, and others as the directors of companies that looted the Columbia Bank and Trust Company. Many of the same names appear as the officers of companies mentioned above.[2] W. L. Norton, Frank Foster, V. McFadden, and W. C. Raymond were the officers of the Exchange Oil Company; Frank Foster, W. C. Raymond, and L. A. Rowland were the three directors of the Landon Investment Company; and L. A. Rowland and James A. Veasey were directors of the Southwest Mortgage Company. The Exchange Investment Company is an interesting specimen. There is no record of this company either in the office of the secretary of state or in the office of the state corporation commission; neither does Bradstreet's representative in Oklahoma City have any record of such a concern; yet this company on the security of W. L. Norton secured $57,750 from the bank in question. Most of these coadjutors of Norton were Bartlesville men,

[1] See pages 49–50.

[2] Data procured from the articles of incorporation in the office of the secretary of state, and from records in the office of the state corporation commission.

but their activities were not confined to that locality. L. A. Rowland and the other organizers of the Southwest Mortgage Company were from Bartlesville, yet this company's principal place of business was Oklahoma City. This company was capitalized for a million dollars, but there is neither record of any capital paid in nor list of stockholders. The best informed real-estate men in Oklahoma City cannot recall such a company, yet the stock of this corporation was widely used as security for large loans obtained from many banks. No record can be found of most of the other concerns, although the name of Norton, invariably appearing as security for the loan, gives an indication, without doubt, of their general nature. Most of these companies were organized in the boom period of 1907 to 1911, and almost without exception they were extinct by 1912. It is believed that these details will help to give a more definite conception of how this coterie of speculators looted banks and the guaranty fund.

As before stated the Alamo State Bank took over this worthless paper from the Oklahoma Trust Company on January 3, 1910. The Alamo Bank struggled under this load for nearly eight months when, on August 25, it was taken over by the bank commissioner. To liquidate this bank the Union State Bank of Muskogee was organized, the banking board agreeing to protect it against loss. The Union State Bank in turn began to accumulate objectionable paper and on September 15, 1913, the bank commissioner was compelled to take over this bank. The loss to the guaranty fund, however, was only $7393.41.

With the exception of the Columbia Bank and Trust Company the foregoing are some of the representative bank failures that have occurred outside of Oklahoma City. With a few exceptions they were comparatively small banks. The figures for these failures have, for the most part, been taken from late Reports of the bank commissioner, but in some cases the bank commissioner is still

liquidating assets, so from time to time successive reports will show some reductions.

But by far the greatest loss has been sustained in Oklahoma City. In this town alone over one and a half million dollars has been paid from the guaranty fund. This amount has since been materially reduced, and on March 1, 1920, the net loss was as follows:[1] The Columbia Bank and Trust Company, $582,283.79; the Night and Day Bank, $365,-228.58; the First State Bank, $148,260.96; the Planters' and Mechanics' Bank, $105,625.91; the Oklahoma State Bank, $61,742.72; and the First State Bank of Capitol Hill, $36,003.82; making a total of $1,299,145.78. This was more than one half of the total loss of the state. These great Oklahoma City losses have shown the danger of a twofold concentration of risk; namely, the concentration of risk in a certain bank and the concentration of risk in a certain community. When the Columbia Bank and Trust Company failed it held about six per cent of the aggregate deposits of the state banks. Such a concentration of risk raises serious actuarial problems. The fact that over half the losses were sustained in one city of the state shows the possibilities of injustice in the distribution of the burdens and the benefits of the law as between communities.

We have already delineated the part played by the Columbia Bank and Trust Company in the Oklahoma City failures. But the Columbia wreck was not the only Oklahoma City failure that smelled to heaven. This city has some other malodorous banking history which should not be permitted to perish. This history centers in the personalities of I. M. Putnam and his confederates in their attempt to promote city additions and town-sites. The banks in question were, for the most part, the Night and Day Bank and the Planters' and Mechanics' Bank — two banks whose combined loss cost the guaranty fund upwards of a half-million dollars.

[1] Records in the Bank Commissioner's Office.

First a word regarding Mr. Putnam. Where he came from no one seems to know exactly. He was reported to be worth two million dollars and apparently was drawn to Oklahoma by the pioneer's passion for building new institutions. But he was no Rufus Wallingford — on the contrary, he was a man mild and unassuming in personal manner, and rather unsystematic in his personal habits and the conduct of his office. He was not out to swindle any one. The consensus of opinion in Oklahoma City is that, in the main, he was an honest man — but a man intoxicated by the sight of new cities rising before him in his dreams.

Before Mr. Putnam came to Oklahoma City the Oklahoma Railway Company began to boom a small town nine miles northwest of the city. They bought the town-site as cheap agricultural land and hoped by building the car line out to it to sell it off at a handsome profit as city lots. Then Putnam came. The project appealed to him and he bought out the Oklahoma Railway Company's interest in the place and named it Putnam City. He then secured control of other land in the same neighborhood, making in all about eight thousand acres. Putnam now conceived the idea of getting the proposed new state capitol building located at Putnam City. He made the state the proposition that if it would locate the state capitol at Putnam City, he would turn over to the state this eight thousand acres. The state was to get the first million dollars when the lots were sold, after which he was to get the rest. A railway with elevated crossings was to run from Oklahoma City to Putnam City — making the nine miles in about eight minutes. Just why Governor Haskell became such an enthusiastic convert to the project is not known, but at any rate he lent his influence to the movement to locate the capitol at Putnam City. To Putnam the proposition had all the allurements of a potential fortune and he launched out yet farther.

Putnam now gave his attention to the promotion of

development companies of sundry kinds. In May, 1912, he testified in the United States District Court that his interests in various companies in 1910 were as follows:[1] College Park Land Company, 95 to 99 per cent; College Park Development Company, one sixth interest; Military Park Development Company, $240,000; Putnam City Company, $1,000,000, 75 to 80 per cent; Putnam Company, practically all; Lakeside Development Company, 75 to 95 per cent; Ellis Place Development Company, $200,000, 75 per cent.

Putnam testified that in 1910 the companies which he controlled owned more than eight thousand acres of land in the immediate vicinity of Oklahoma City. He testified that the land was worth at that time from $250 to $2400 an acre, averaging probably $1000 an acre or more. The highest valuation was placed on the 133 acres comprising the town-site of Putnam City, which he said was worth at that time $2400 an acre. The lowest was on land lying two miles north and west of Putnam City, which was listed at from $250 to $400 an acre.[2]

These outrageous values placed upon barren open-country land nine miles from Oklahoma City were accepted as safe by the parties from whom Putnam obtained his money. These wild estimates were the product of the febrile mind of the promoter and any foundation they might have was contingent upon the location of the capitol building at Putnam City.

Putnam secured control of these various development companies in two ways. In some cases he gave his unsecured notes to the bank in return for the desired funds. Sometimes his notes were secured by stock of the above-named companies capitalized at the values already given. Another means of securing funds was to deed Putnam City property to his employees and others in return for their notes and then sell the notes to two or three Oklahoma City banks.

[1] *The Oklahoma City Times*, May 28, 1912, p. 2. [2] *Ibid.*.

R. S. McLean, formerly Putnam's private secretary, on the witness stand identified the names attached to a long list of notes which formed a part of the assets of the Night and Day Bank as those of Putnam's employees, his own being among the number. The list included salesmen, bookkeepers, stenographers, and even the telephone operator in Putnam's office.[1]

Most of this "Putnam paper" was held by the Night and Day Bank and the Planters' and Mechanics' Bank. Its value, as we have said, was contingent upon the location of the new capitol building at Putnam City. When the legislature met in 1910 Governor Haskell used all of his influence to get it to accept Putnam's proposition. The legislature refused. In 1911 a new governor and a new legislature located the capitol on the northeast side of Oklahoma City, about nine miles from Putnam City, and Putnam's project collapsed like a house of cards. Most of the eight thousand acres of land, which Putnam valued at an average of $1000 or more an acre in 1910, was now valuable only as agricultural land, and since it is poor land its value was probably about $75 an acre.

The Night and Day Bank of Oklahoma City was the principal victim of this Putnam City episode. Abner Davis, the owner of the Oklahoma City baseball franchise in the Texas league, was the president of this institution. But Davis was not the owner of the bank, for Davis had no money of his own. I. M. Putnam wanted an institution through which to finance his projects, and Abner Davis, as president of this bank, was only a dummy set up by Putnam. Davis, as already stated, had no money of his own, but that is not definitive proof that he could not buy a bank. As a financial operator Davis was a rare genius and the methods employed by him and Putnam in purchasing this institution from its former owners are interesting in the extreme.[2] The parties to this deal were four in number —

[1] *The Oklahoma City Times*, May 22, 1912, p. 1.

[2] The information for this paragraph was procured from a man who at the time was in a position to know every phase of the transaction.

Putnam, Davis, the First State Bank of Oklahoma City, and the Oklahoma Trust Company of Muskogee. Putnam put a batch of his Putnam City paper into the First State Bank of Oklahoma City, not receiving credit, however, until this bank had shifted the paper to the Oklahoma Trust Company of Muskogee. Now that the First State Bank had its credit with the Muskogee institution, it credited Putnam with a deposit of about $50,000, the amount of the deal. Putnam at once transferred this deposit to Abner Davis's credit. Davis then checked against this deposit to pay for the stock of the Night and Day Bank. Davis now owned a bank, and he immediately transferred (presumably this was a part of the agreement) enough of the funds of his newly acquired bank to the Oklahoma Trust Company to protect them against the Putnam paper they had taken from the First State Bank of Oklahoma City. The Oklahoma Trust Company, having received its money, permitted the First State Bank to withdraw its deposit. Everybody now had his money and Davis had purchased a bank with its own deposits. It is of interest in this connection to call attention to the fact that this First State Bank of Oklahoma City later became insolvent and cost the guaranty fund $148,260.96, while the Oklahoma Trust Company will be recognized as the institution that foisted on to the Alamo State Bank of Muskogee the worthless oil and investment paper of W. L. Norton and his coadjutors. Such were the parties to this disreputable manipulation.

Under the direction of the new management an extensive advertising campaign greatly augmented the deposits of the Night and Day Bank. What loanable deposits were left after paying for the bank were used principally for lubricating the deals of Putnam and his associates. The fact that this bank had deposits of $550,000 when it closed, yet only $16,012.67 was realized from the assets, serves as an indication of the magnitude of this bank robbery. Among the uncollectible assets of this bank there yet

remain some sixty notes, aggregating over $112,000, signed either by Putnam or some of his employees.[1] Besides this sum there is a considerable amount of other paper drawn in the name of the before-mentioned Putnam development companies. "M. R. Garnett, a former state bank examiner and deputy bank commissioner at the time of the Davis trial, testified that in 1910 the bank commissioner had ordered the bank to charge off a long list of notes which were not regarded as satisfactory, but a large number of them were still in the bank when it was taken over by the banking board." [2] Oklahoma sowed the wind when Governor Haskell refused to prosecute the officials of the Columbia Bank. Now she was reaping the whirlwind.

In the wreckage of this bank there yet remain a number of notes amounting to $70,000 drawn by Margaret McKinley. In order to understand what these notes stood for a few words must be said concerning this remarkable personage. As is the case with many other people in Oklahoma, where Margaret McKinley came from is not just clear, but at any rate she was a good accountant. After reaching Oklahoma City she held various clerical positions. Then she was hired to audit the books of Oklahoma County. From this position she went to better ones, though still working on a very modest salary. With a little of her savings she invested in Oklahoma City real estate. As these ventures proved fortunate she began to speculate a little, although still continuing her accustomed work. Fortune continued to smile on her, and after amassing a modest competence she quit work and gave herself over to the speculative fever. She now cast aside all restraints and her fortune mounted upward, until she became involved in the Putnam City orgy and with its collapse her career ended.

[1] Records in the Bank Commissioner's Office.

[2] *The Oklahoma City Times*, May 23, 1912, p. 1.

Under its new management this Night and Day Bank was dishonest in its very inception. Its deposits, funds held in trust by the bank officials, were used to further the most visionary and questionable projects. The other state bankers paid the bill.

After the closing of the Night and Day Bank Abner Davis, its president, spent four years in a legal fight to escape the United States penitentiary. He first faced two trials in the State District Court on charges growing out of the bank's failure. Here he was acquitted.[1] The United States Government then indicted him on five counts and on June 3, 1912, the United States District Court jury brought in a verdict of guilty on one count. This count was that Davis had sent a statement of the bank's condition through the mails when he knew that it was false.[2] United States District Judge John H. Cotteral then granted Davis a new trial because it was shown that a person had told one of the members of the jury that he would not believe Davis on oath.[3] Before a new trial occurred he was convicted in the United States District Court at Memphis, Tennessee, with five others, on three counts, one of conspiracy and the other two for the use of the United States mails to defraud. The case was appealed to the United States Circuit Court of Appeals, and on April 4, 1916, this court overruled the lower court on all three points. The court gave its reasons in the following words:

> The Memphis bank went into the hands of a receiver August 9, 1911. Among its assets, and constituting more than half of its ostensible loans and discounts, were notes of, or endorsed by, I. M. Putnam, of Oklahoma City, amounting to about $50,000. Thirty-one thousand dollars of these notes had been discounted at the Memphis bank about March, 1911, and $16,000 in December, 1910, by respondent Davis, acting either for himself or for the Oklahoma Night and Day Bank, of which he was, until January, 1911, president and manager. This Putnam paper, at the

[1] *Bank Deposit Guarantee Journal*, February, 1912, p. 14.
[2] *Ibid.*, July, 1912, p. 25.
[3] *Ibid.*, July, 1912, p. 11.

time of the trial of this case, was regarded as nearly or quite worthless.... Davis was neither stockholder nor director in the Memphis bank; he had nothing to do with its management; and he touched its affairs from its birth to its death at only two or three points. The chief one is in relation to the Putnam paper. He and Hendrey shifted $50,000 of this paper from his shoulders or those of his bank to the Memphis bank. There was, doubtless, a personal profit in this paper for Davis, and, perhaps, as to a part or all of it, for Hendrey; and if, in truth, they took to themselves a large amount of the Memphis bank's good assets in exchange for paper which was worthless or partly so to their knowledge, this would be a scheme to defraud the bank and certainly its stockholders and perhaps its depositors; but Davis was not on trial for anything like that; no such scheme is hinted at in the indictment; and it cannot be permitted that any respondent shall be charged with one crime and convicted of another merely because the latter is developed out of the proof which fails to show the crime charged.[1]

This shows the circumstances to which Davis owes his freedom. It is now nearly ten years since the Oklahoma City failure, and since every one in Oklahoma is trying to forget the past, it is highly improbable that any further charges will be pressed against him.

The Planters' and Mechanics' Bank, the First State Bank, the Oklahoma State Bank, and the State Bank of Capitol Hill — all Oklahoma City failures — represented a loss to the guaranty fund of nearly half a million dollars. Most of these banks were victims of the boom. What Putnam was doing at Putnam City was duplicated on a smaller scale in all parts of the city. When this boom was gathering momentum these banks made heavy loans to various development projects extending far into the surrounding country. When the boom collapsed they found much of this inflated real-estate security nearly worthless. Thirty thousand dollars of Putnam paper yet remains among the uncollectible assets of the Planters' and Mechanics' Bank. Dishonest and incompetent banking tells

[1] Hendrey *v.* United States, 233 *Federal Reporter*, 5, 13, 16.

the whole story of these six Oklahoma City failures. One class of bankers was in collusion with the speculator; the other was the speculator's victim — together they dealt a blow that staggered the infant guaranty system. It is patent that four or five banks in Oklahoma City had accumulated a great part of the speculative paper of this boom period between 1907 and 1911. If there had been no guaranty law the dead weight of this whole loss would have fallen on the individuals of the community. It is more than probable that this would have proved a body blow to public confidence with consequences of great general import. The guaranty law disseminated the shock over the entire state, and, the ethics of the case aside, permitted the business life of this city to move on without interruption.

Another fact worthy of note is the difficulty of convicting bank officials that have proved grossly recreant to duty. We have already seen how Abner Davis wriggled through the fingers of both the state and the United States courts. The ordinary banker is a respected citizen of his community and when indicted for bank wrecking is tried before a jury of his fellow-citizens. Under a guaranty law these persons can suffer no loss and this, coupled with local sentiment, makes convictions extremely difficult. If all of the Oklahoma City losses had fallen on the individuals of that community, it would have been comparatively easy to get juries that would have dealt summarily with such persons as Abner Davis. Many thoughtful persons believe that the guaranty fund should be created in part from a general tax levy in order that the public may have a more direct interest in the activities of bankers, not only while they are managing banks, but also when they are later before the bar of justice for wrecking them.

The handling of these failed banks has witnessed a marked step forward in the manner of liquidating failed institutions. The old method of liquidating a failed bank was to put it in the hands of a receiver. This receiver had

little or no expert knowledge for the task in hand. In addition to this there were many onerous attorney fees as well as other expenses incident to the legal closing of the business. Ineptitude and waste was the result and the whole burden of this fell upon the depositors of the failed institutions. In most of the states that have guaranty laws a deputy bank commissioner takes charge and liquidates a failed bank. This official is a trained banker and his salary is paid from the general funds of the state. The result is that the assets are in the hands of an expert and every cent saved goes back to the depositors.[1] This is a great step in advance of the old antiquated receivership, and a step that other states may well afford to follow.

8. *The burden and the incidence of the guaranty assessments.* It took but the first few of these fifty-odd failures to deplete the guaranty fund. When the fund could no longer meet the losses the state banking board began to issue certificates of indebtedness as required by law. For a few years the amount of these certificates issued was alarming, the statement of the condition of the guaranty fund on September 30, 1914, showing that there was $20,161.38 in cash on hand and $807,475.09 in warrants outstanding against it.[2] Since then these warrants have been paid off as will appear later. To create a market for these warrants they were made non-taxable, legal security for the deposit of public funds and for any other deposits that may be required by the state treasurer.[3] By these means their

[1] An exception to this general statement was the liquidation of the Columbia Bank and Trust Company. It would be difficult, for the business in hand, to exaggerate the incompetence of the politicians who closed this bank. The expense of this liquidation from September 29, 1909, to January 30, 1911, was $14,922.70, of which amount $8,750 represented attorney fees. See *Report of Arthur Young & Company*, pp. 59–61. This practice of hiring special attorneys was soon after abandoned and now work of this nature is under the care of the Attorney-General.

[2] *Fourth Biennial Report of the Bank Commissioner.*

[3] *Banking Laws of the State of Oklahoma*, section 47.

standing was maintained in the eyes of the public and on them enough money was borrowed to pay depositors as required by law. But these warrants do not show that the whole burden of the system was, for the time being, shifted to the future. When the Columbia Bank and Trust Company failed the emergency assessment was made three fourths of one per cent of average daily deposits, and on March 2, 1911, this was increased to one per cent. The following table gives the data regarding the assessments for the various years:

Year	*Percentage assessment*	*Average daily deposits of preceding year* *	*Assessment*
1908............	1	$19,883,663	$198,836.63
1909............	1 Increase †	5,214,011	52,140.11
1909............	1/5	25,097,674	50,195.34
1909............	3/4 Special	30,006,966	225,052.23
1910............	1 Increase	19,603,175	196,031.75
1910............	1/5	44,700,849	89,401.69
1911............	1 Increase	2,914,879	29,148.79
1911............	1/5	47,615,728	571,388.73
1912............	19/20	53,795,163	511,054.04
1913............	2/5	50,456,166	201,824.66
1914............	2/5	37,021,000	148,084.00
1915............	2/5	40,454,322	161,817.29
1916............	1/5	44,981,826	89,963.65
1917............	1/5	66,677,846	133,355.69
1918............	1/5	104,400,000	208,800.00
1919............	1/5	115,981,000	231,962.00
1920............	1/5	150,829,000	301,658.00
Totals....		$859,633,268	$3,400,714.60

* The average daily deposits as given in the 1908 column are not those for the preceding year, 1907, for there are no statistics of average daily deposits before statehood. The deposits on which the first assessment was based were those as shown by the bank examination made before the law went into operation. See the First Annual Report of the State Banking Board, p. 4.

† It will be remembered that the original law provided that in the event the average daily deposits of any bank should be larger for the succeeding year, it was required to pay an assessment equal to 1 per cent of the increase. This provision was removed from the law by an amendment in 1911.

Since the first special assessment, which occurred in 1909, was not levied on the average daily deposits of the

preceding year, it is apparent that this item in the table causes a duplication to the amount of $25,097,674 in the deposits for that year. If this amount is subtracted from the total average daily deposits, $859,633,268, and the remainder divided into the total assessments, $3,400,714.60, the quotient is .408, or the average annual rate per cent which one hundred dollars of deposits has been assessed over this twelve-year period. Since the deposits of the Oklahoma banks have averaged considerably over five times their capital stock this average annual rate of assessment of .408 per cent of deposits is in the neighborhood of 3 per cent of the average capital stock of the banks. Thus the total assessments for the twelve years have taken about 36 per cent of the average capital stock of the banks.[1] To date the banks have paid in almost three and a quarter million dollars in assessments. Up to November, 1912, the assessments of the Oklahoma State Bank of Muskogee had amounted to $17,010.40.[2] Mr. Thornton Cooke gives the following as special cases related to him:[3]

In four	years	one	bank	of	$50,000	capital	paid	$13,000	assessments
"	"	"	"	"	50,000	"	"	10,000	"
"	"	"	"	"	50,000	"	"	15,000	"
"	"	"	"	"	10,000	"	"	1,300	"
"	"	"	"	"	15,000	"	"	3,000	"
"	"	"	"	"	5,000	"	"	2,255	"
"	"	"	"	"	30,000	"	"	20,000	"

These figures show the tremendous burden which the guaranty system placed upon the state banks during the first few years when special assessments were frequent and onerous. In some instances where banks enjoyed especially large deposit accounts, bankers assert that for a few years their annual assessments equaled ten per cent of capital

[1] This is not a weighted average, but it will suffice to show the general situation.

[2] *Commercial and Financial Chronicle*, Nov. 2, 1912, p. 1172.

[3] *Quarterly Journal of Economics*, November, 1913, p. 86.

stock. In the four years 1908, 1909, 1911, and 1912 the annual assessments averaged about five per cent of capital stock. It is patent that an annual assessment equal to five per cent of capital stock trenches seriously on dividends. In 1908 Mr. James B. Forgan, then president of the First National Bank of Chicago, made an investigation as to the earning power of deposits. Based on the statistics of his bank for the past eight years, after allowing five per cent on the average capital employed, the average net profit on deposits, including revenue from all sources, was just three quarters of one per cent.[1] If these figures are trustworthy the assessments in Oklahoma for the first five years were more than the net earning power of the deposits.

The question at once arises, Who in the final analysis has really borne the prodigious burden of this experiment? The state bankers, of course, sustained the impact of the tax, but it is far from certain that the burden finally reposed there. Insurance is a scheme for providing indemnity and for scattering the effects of a disaster over the members of a group — a disaster which otherwise would have fallen with crushing blow upon some few individuals of the group. Each member of the group, recognizing the aleatory nature of the impending danger, chooses to contribute regularly a known amount in order to remove the possibilities of a much greater disaster. Thus, in insurance the normal thing is for the person insured to bear the costs of his own insurance. It is true that insurance may be philanthropy, but there is little philanthropy in business. Where the state imposes an insurance contribution upon an enterpriser it becomes to him one of the costs of his business and must be met somewhere. In the long run any business must bear its own expenses, or, in the language of the street, "the consumer pays the freight." Some of the coal companies in Pennsylvania, when invoicing a car of coal boldly add five cents per ton and mark it "state workmen's compensation

[1] Forgan, *Guaranty of National Bank Deposits* (pamphlet), p. 16.

tax." [1] The problem before us is whether the State of Oklahoma has compelled the state bankers to assume the burden incident to insuring the depositing public.

It is a commonplace that every tax has a tendency to be shifted. Professor Plehn says regarding the taxation of mortgages:

> In California the attempt was made to compel the lender to pay the tax by at least making him advance it. But it became evident, however, that he shifted the tax to the borrower, whose last state was worse than his first, because he had to pay not only the tax, but the cost of shifting as well. [2]

Methods of shifting taxes are almost myriad. If it seems inexpedient to the manufacturer to increase the price of his finished product he may accomplish his purpose by employing a slightly inferior grade of raw material in the manufacturing process. The assessment that a bank must pay to the guaranty fund is in every respect a tax. A bank might shift this burden in various ways — it might maintain an inferior plant, it might extend less liberal banking accommodations of various kinds to the public; finally, it might boldly raise the interest rate to the borrower. Discussion of the first two methods will be summarily dismissed, for it is impossible to present definitive proof one way or the other. As regards equipment persons conversant with conditions throughout the country ridicule the idea that there is any difference when comparable conditions are considered, and certainly it would seem an exaggeration to say that the general public in Oklahoma suffer in this respect as compared with persons in other states. But this is impression, not statistical proof. The same thing seems to be true as regards the liberality of banking practices. As a rule the Oklahoma banks pay one per cent higher rate on time certificates of deposit than is the custom in most other states. With respect to special charges for other banking services,

[1] *American Industries*, April, 1916, p. 42.
[2] *Introduction to Public Finance* (revised ed.), p. 276.

again it is impossible for the stranger to detect any differences. These general practices seem to be the same as those obtaining in other states. There remains the question of a higher interest rate to the borrower.

There might be a possibility that the guaranty law has attracted sufficient additional deposits to the state banks to make the additional profits from this source offset the onerous assessments. In such a case the burden would have an offset. For a time the deposits of the state banks greatly increased. The advertising the law received in the early political campaigns, the rush to organize new banks, and the conversion of national banks all contributed to this end. When the failures began to occur the state banks nationalized by the score. Through all the storm the national banks have retained the confidence of the public until now, although the state banks outnumber the national almost two to one, the national banks hold fully two thirds of the total deposits of the state. It is hard to see, therefore, where the law has been a sufficient boon to the state banks to offset its burdens.

The general theory of the shifting and the incidence of taxation is based upon long-run conditions. It is a part of the theory that the person who advances the tax regards it as a hardship and consequently looks about for some avenue of escape. But this part of the theory of tax-shifting does not quite fit the matter in hand. In the first place, when the law was passed most of the banks anticipated that it would be a great deposit-getter. They felt that its benefits would far outweigh the costs and they undoubtedly approached the matter in a frame of mind quite different from that of the man who recoils under the impact of a tax. Finally, the heavy special assessments were concentrated in a comparatively few years, and it is doubtful if the banks regarded them as a permanent handicap. Consequently the obsession of mind on the part of the taxpayer who contrives to shift the burden and the

long-run conditions that are so necessary for the general theory of tax-shifting were hardly present.

There was an important influence at work tending to compensate the state banks. When the law was passed it provided that state banks could not pay a higher rate of interest on time deposits than that permitted by the bank commissioner. This rate was placed at four per cent. The state banks were thus paying only four per cent on such deposits, while their competitors were paying all the way from four to ten per cent. It is patent that if the guaranty law did no more than assist a bank in holding its deposits at a lower rate, this regulation regarding the rate of interest would place the state banks in an advantageous position. No doubt this was of some consequence.

It must be remembered that the state banks are working in competition with the national banks, which are not subject to the law. At first blush this competition would seem to make it impossible for the state banks to shift the burden. But often this competition is more nominal than real. As a rule the national banks are the large banks of the state; they operate in the larger cities and towns; and their clientèle consists of the larger borrowers. At many points these two banking systems do not come into competition. Where they do come into competition it is quite possible that the result is just the reverse of what might be expected. In this case both kinds of banks are competing for the same market. The guaranty assessment places a handicap on the state banks, with the result that they cannot cut the rate below a certain point. The national banks, occupying an advantageous position in this regard, accept the rate of the state banks and thus do not compete. For this reason it is doubtful if the competition of the national banks is, after all, any competition at all. From the standpoint of abstract reasoning, therefore, the final incidence of the guaranty assessments is most complicated and uncertain.

Attention is now called to some of the actual conditions regarding the interest rate in Oklahoma. In 1915 the Comptroller of the Currency collected statistics as to the rates of interest charged by the national banks in the various states.[1] The figures refer only to national banks and show the number of banks charging twelve per cent or more on some loans. The following table gives the figures for Oklahoma and neighboring states:

	Total number of national banks	*Number charging 12 per cent or more on some loans*	*Percentage charging 12 per cent or more*
Oklahoma	351	287	81.7
Texas	535	168	31.4
Kansas	217	21	9.7
Arkansas	61	7	11.5
Missouri	131	19	14.5

This table shows that 81.7 per cent of the national banks in Oklahoma were charging 12 per cent or more on some of their loans. This percentage was greater than that of any other state. In fact, there were almost twice as many offending banks as in Texas, the next lowest state. There are no figures available for the state banks, but it is safe to say that practically all of them were guilty of the same practice. The tenant cotton-grower, and in some sections especially the negro tenant, is the principal cause of this acute interest condition. The worldly goods of the typical cotton tenant consist of a team, a wagon, a cow, and a family. Generally some part of this outfit is mortgaged. To get out a crop this tenant has to borrow money, giving the anticipated crop as security for the loan. The bank loaning him money is running two grave risks — that of a poor crop and the probability of the tenant moving on to another community. The chronic incapacity of the tenant keeps him the victim of the money-lender. Banks in these

[1] *Report of the Comptroller of the Currency*, 1915, vol. I, p. 28.

rural sections have little competition in this kind of business, and this, combined with the hazard element in the loan, causes the banks to adopt the policy, "Get all you can get." Early in 1916 the Oklahoma state legislature passed a stringent anti-usury law, revoking the charter of the banks guilty in the future and denying them access to the state courts to collect usurious loans.

The general high rate over the state is due to a plurality of causes. In a new state such as Oklahoma has been in the past, there is little accumulated capital. The demand for capital for developmental purposes far outruns the available supply. Furthermore, in such new communities values are very unsettled, consequently the element of hazard in a loan is great. The interest rate is thus made up of two parts — the pure interest rate, determined by the supply of and demand for capital, plus an insurance rate to cover the element of hazard in the loan. In the past both of these elements have made for high interest rates in Oklahoma. In addition to this is the burden of the guaranty assessments. It is manifestly impossible to allocate to these several factors their exact share in the cause of high interest rates.

While we cannot measure directly the effects of the guaranty law on interest rates, we can determine pretty accurately how the state banks have prospered under its operation. The following table shows the average annual dividends declared by the state banks in Oklahoma as well as for the state banks in neighboring states:

	1911* (*per cent*)	1912* (*per cent*)	1913 (*per cent*)	1914† (*per cent*)	1915† (*per cent*)
Oklahoma	15.7	16.8	15.8	17.9	15.7
Kansas				12.3	12.0
Missouri				11.5	11.3
Arkansas				10.0	9.2
Texas				11.0	11.0

* Bank Commissioner, in address before state bankers, December 9, 1913.
† *Report of the Comptroller of the Currency*, 1914 and 1915.

There are no figures available for the last four states prior to 1914, but as conditions have been normal in these states the figures for the years 1914 and 1915 show the general condition. It will be remembered that the assessments for 1911 and 1912 in Oklahoma equaled about five per cent of capital stock. If these assessments were not shifted the dividends plus the assessments would have been about twenty-one per cent, or nearly twice the earnings of state banks in neighboring states. The problem is far too complex to warrant any dogmatic conclusion that the banks have passed the burden on to the borrowing public, but the above figures provoke a grave suspicion.

The real effect of the guaranty assessments was in all probability not so much to raise interest rates as it was to retard the gradual fall that was taking place. As already indicated, interest rates are extremely high in newly settled countries. As capital accumulates and frontier conditions give way to settled life, the interest rate gradually falls until it becomes consonant with rates in older states. This process has been going on apace in Oklahoma. Probably the real effect of the guaranty burden was to retard this decline. In so far as this is so, all borrowers from banks, both state and national, have been affected. It is safe to say that interest rates in Oklahoma average from one to three per cent higher than in the neighboring State of Kansas, notwithstanding the fact that Oklahoma now has as much wealth as the latter state and nearly half a million more people. It would be interesting to know the nature of the friction that is retarding further decline.

9. *The effects of the law on the state and the national banks.* So far, in considering the Oklahoma experiment, we have dwelt upon the initiation of the bank-guaranty idea in Oklahoma, the characteristics of the Oklahoma law, and have traced the history of the guaranty fund and the bank failures. With these facts in mind we now turn to a con-

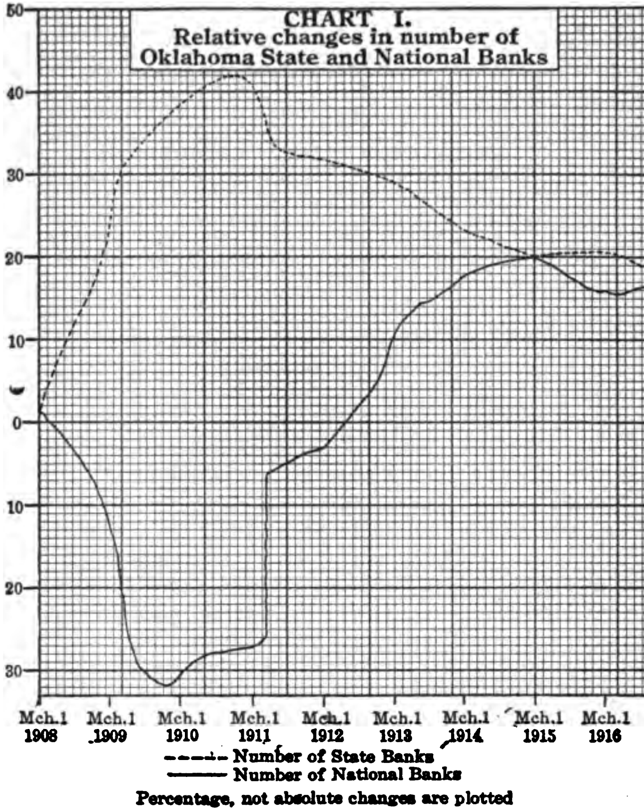
sideration of the relations of the banks and of the people to the law.

It will be remembered that the Oklahoma bank-guaranty law was born in the throes of the panic of 1907. This tie-up of currency worked a real hardship. The law was presented to the public as a panacea for this very thing. Consequently the effects of the law have been more pronounced than in any other state. These effects show most conspicuously in the relative growth of the deposits of the state and the national banks, and in the relative changes in number of the same banks.

On March 1, 1908, the individual deposits of the state banks were $18,032,000. By November 16, 1909, these had increased to $49,775,000, or an increase of over 175 per cent.[1] On the same dates the individual deposits of the national banks in Oklahoma were $38,298,000 and $41,617,000 respectively, or an increase of less than 9 per cent.[2] On March 1, 1908, there were 470 state banks in Oklahoma. By November 16, 1909, there were 662.[3] This was an actual increase of 192 banks, or 41 per cent. On the same dates the number of national banks in Oklahoma was 312 and 220 respectively.[4] This was an actual decrease of 92 banks, or 30 per cent. These figures show that the bank-guaranty law, coming at the psychological moment, caught the public ear. This great increase in deposits of state banks undoubtedly shows that the public preferred the guaranteed banks. But this is not the whole explanation. The bankers of the state greatly overestimated the ability of the law to attract deposits. Some of the national banks, being deprived of the benefits of the law, felt compelled to renounce their national charters and incorporate under the state laws. Besides this conversion of national banks there were 100 new state banks organized

[1] *Second Biennial Report of the Bank Commissioner*, pp. xxvii–xxviii.
[2] *Ibid.*, pp. xxx–xxxii. [3] *Ibid.*, pp. xxvii–xxviii.
[4] *Ibid.*, pp. xxx–xxxii.

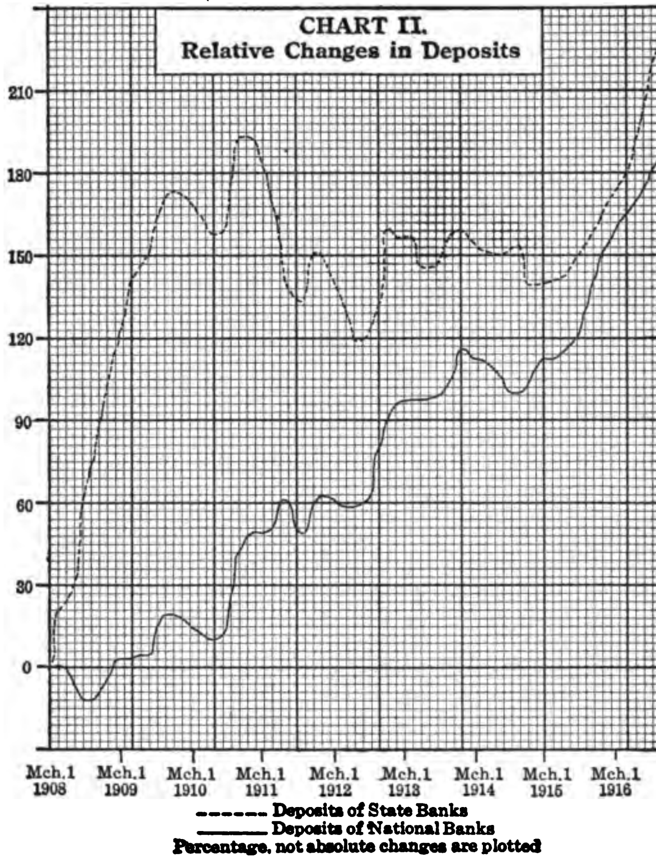
between the two above-mentioned dates. A regular mania for bank organization broke out. Small banks with a minimum of capitalization sprang into existence in nearly



every hamlet of the young commonwealth. The bank commissioner stated that more than three hundred applications for state-bank charters were on file in his office.[1] The principal cause of this phenomenal growth of state-bank deposits was the conversion of the 92 national and

[1] *Quarterly Journal of Economics*, 1913, 28: 88.

the organization of the 100 new state banks. This growth of state banks kept up until 1911, when on January 7 of that year their number was 695, with deposits aggregating



$54,756,000.[1] The state banks had been chafing for some time under the burden of the Columbia failure. When on top of this came about twenty other failures and an emer-

[1] *Third Biennial Report of the Bank Commissioner*, p. xxxiii.

gency assessment of one per cent of deposits, the burden became serious. In January of the same year came the decision of the United States Supreme Court upholding the constitutionality of the law. This decision removed all uncertainty as to the possibility of the system being terminated by the courts, and the exodus from the state banking system began.

On January 7, 1911, there were 695 state banks in Oklahoma. By February 20, 1912, this number had fallen to 628,[1] being an actual decrease of 67, or 10 per cent. On January 7, 1911, the individual deposits of the state banks amounted to $54,756,000. By February 20, 1912, they had fallen to $39,391,000,[2] being a decrease of $15,365,000, or over 18 per cent. This was for a period covering about a year, but when we examine the three-months period from March 7, 1911, to June 7, 1911, we find the tendency even more striking. Between these two dates the number of state banks fell from 690 to 638,[3] a loss of 52. In this same period the individual deposits fell from $49,723,978 to $39,202,440,[4] a loss of $10,521,538. If we examine the figures for the national banks in Oklahoma for these same periods, we find that the movement was nearly the reverse. On January 7, 1911, there were 229 national banks. By February 20, 1912, they had increased to 283,[5] being a gain of 54, or nearly 24 per cent. On March 7, 1911, the individual deposits of the national banks amounted to $48,169,089, and on February 20, 1912, they were $53,094,824,[6] being an increase of $4,925,735. Again, if we consider the three-months period from March 7, 1911, to June 7, 1911, we find that the national banks increased from 229 to 276, a gain of 47, and individual deposits increased from $48,169,089 to $52,253,351, a gain of $4,084,262.[7]

By the beginning of 1917 this movement seems nearly to

[1] *Third Biennial Report of the Bank Commissioner*, p. xxxiv.
[2] *Ibid.*. [3] *Ibid.*, pp. xxxiii–xxxiv. [4] *Ibid.*.
[5] *Ibid.*, pp. xxxvii–xxxviii. [6] *Ibid.*, pp. xxxiii–xxxvii.
[7] *Ibid.*, pp. xxxvi–xxxvii.

have spent itself. It is true that the number of state banks had decreased to 547, being a loss of 148 since January 7, 1911, but the national banks were also decreasing, numbering only 338 on December 27, 1916.[1] By this time the great wave of war-time deposits was flooding the banks, and both the state and national banks seemed to prosper equally. In the next two years the national banks, as regards numbers, did little more than hold their own, while the state banks increased to 606 by March 1, 1920. When it is considered that many of the state banks were capitalized at $5000 and $10,000, and that the minimum capitalization for a national bank is $25,000, it is evident that many state banks could not nationalize. No doubt this fact made the exodus to the national system much smaller than it might otherwise have been. These figures show one of the most remarkable episodes in the financial history of this country, and they furnish a striking example of how legislation may disturb well-established business customs and tendencies.

It was the large state banks that the guaranty law drove into the national system. The report of the bank commissioner issued in 1914 showed 43 state banks with a capitalization of $5000; 271 with a capitalization of $10,000; and 90 with a capitalization of $15,000. There was one state bank with a capital stock of $75,000, and one with a capital stock of $100,000. At the same time there were 38 national banks in Oklahoma with a capital stock of $100,000 or more.[2] This restriction of the state banking system to the smaller banks was a more serious matter than it might seem, for it automatically increased the burden on the remaining state banks incident to paying off the indebtedness of the guaranty fund.

These seceding state banks became involved in interesting legal complications. It will be remembered that the

[1] *Fifth Biennial Report of the Bank Commissioner*, pp. 280–84.
[2] *Report of the Comptroller of the Currency*, 1915, vol. II, pp. 745–57.

law as amended in 1909 provided for the creation of a guaranty fund equal to five per cent of average daily deposits. One per cent of this was levied the first year, and one fourth of one per cent each succeeding year until the five per cent fund was accumulated. This spread the assessments over a period of seventeen years. When the large state banks seceded they maintained that they were liable for only such assessments as fell due while they were yet state banks. The State Supreme Court, however, denied the right of a bank to slip out from under a part of the assessment in this manner. This court decided that the five per cent assessment of 1909 was a present existing obligation assumed by each state bank and that the surrender of the state charter did not terminate the obligation.[1] This decision was of special interest in the light of the fact that the amendment of 1913 reduced this assessment from five to two per cent of average daily deposits. The amount claimed by the state in this action was $646,-542.14. However, the banks interested by this decision were granted a rehearing, and in June, 1919, the State Supreme Court reversed itself, holding that the banks were liable for only such portion of the assessment as fell due while they were yet state banks.[2] While this question was in litigation the state banking department collected some $35,000 or $40,000 from a dozen or more banks. At the present time there is no provision for returning this money, and it seems probable, therefore, that the banks have lost it.

10. *Causes of bank failures.* It is evident that the near breakdown of the Oklahoma system was caused by the frequent and serious bank failures. Looked at broadly, these failures seem to have been caused by the operation of

[1] State *v.* Farmers' National Bank of Cushing, 150 *Pacific Reporter*, 212.

[2] Citizens' National Bank of Broken Arrow *v.* State, 184 *Pacific Reporter*, 63, 76 *Oklahoma*, 94.

three forces; namely, first, a spirit of speculation on the part of bank officials; second, weakness in the construction and administration of the guaranty law and the other general banking laws; and, third, changes in economic conditions incident to the rapid development of the new state. These general causes are not of equal importance; on the contrary, the third is the fundamental one. It is very necessary to keep this fact clearly in mind. If certain features of Oklahoma's economic history are not kept in the foreground there will be the grave danger of jumping to the conclusion that bank guaranty has failed, when, in so far as Oklahoma is concerned, it has hardly had a fair chance.

It will be recalled that the first "run" for Oklahoma land occurred in 1889. The second was four years later followed by other less important openings. We may say, then, that what has been accomplished in Oklahoma is the work of about twenty-five years. The population of the state in 1920 was 2,027,564. In point of population she stood twenty-first among the states of the Union. In 1912, five years after statehood, the wealth of the state had passed the four and one-half billion dollar mark.[1] At that date Oklahoma stood fifteenth in wealth among the states. This wealth of Oklahoma was greater than the wealth of Maine, New Hampshire, Vermont, and Connecticut combined; greater than the combined wealth of North Carolina, South Carolina, and Mississippi; greater than the combined wealth of Montana, Idaho, Wyoming, New Mexico, Arizona, Utah, and Nevada. In 1914, a typical year before the war-time price inflation of farm products, the value of Oklahoma's farm crops was about $158,000,000.[2] Her cotton crop of that year under normal crop conditions was worth about $63,000,000.[3] In the same year

[1] Estimated Valuation of National Wealth, 1850–1912, Department of Commerce, Bureau of the Census.

[2] *Year-Book of the Department of Agriculture*, 1914, pp. 514–76.

[3] *Ibid.*.

the value of the live-stock was over $165,000,000.[1] From these figures it is seen that as an agricultural state Oklahoma occupies a unique position. Her cotton crop places her high among the cotton-producing states, while her wheat and corn and live-stock make her comparable with the great diversified farming states of the Mississippi Valley.

It was as an oil-producing state that Oklahoma's rise was most meteoric. In 1900 the output of crude oil for the state was 6472 barrels.[2] In 1910 the output was 52,028,718 barrels, and in 1916, 107,071,715.[3] This output in 1916 was over a third of the total production of the United States and 16,119,779 barrels in excess of the production of California, her closest competitor. The Cushing field proved to be the world's greatest producer, and as this field was extended a veritable oil delirium seized the state. Every one feared that some one else was pumping out the oil from under his land, with the result that a wild pumping race ensued. It is the feverish speculation that accompanied this marvelous oil development that interests us at this time.

The purpose of reviewing these figures of population and wealth development is to give an idea of the rapidity with which events have been moving in that part of the world. All this happened in the short space of twenty-five years. A noticeable reaction of this on the people of that state is shown in their impatience to get a big return on a small investment. There is a general feeling in the state that a project that does not give a return of at least ten per cent net on the capital invested is a mighty poor business. It is this desire for quick returns that should be held in mind as other events in the history of the state unfold.

But Oklahoma was experiencing severe growing pains

[1] *Year-Book of the Department of Agriculture*, 1914, pp. 514–76.
[2] *Statistical Abstract of the United States*, 1915, p. 224.
[3] *Ibid.*, 1917, p. 240.

during this period of rapid development. "As a town built in a hurry is seldom well built, so a society will be sounder in health for not having grown too swiftly." [1] The unhealthy symptoms of Oklahoma's growth appear in the boom that began to gather momentum about 1907 and collapsed in 1911 and 1912. It was this boom that proved the undoing of so many banks, for in it are found crystallized the two arch bank wreckers, namely, speculation and dishonesty. We must guard against the conclusion that this boom was to any appreciable extent caused by the guaranty law. A few words regarding the relation of booms to the settlement of western land will at once make it evident that it was but a recurrence of a well-known phenomenon.

These booms are the result of the pioneer's confidence overreaching itself. "Confidence goes a long way toward success. And the confidence of these Westerners is superb." [2] Charles Dickens, also struck by this western characteristic, gives us in "Martin Chuzzlewit" a glowing description of "the thriving city of Eden as it appeared on paper." But often this confidence developed into recklessness, and, building cities far beyond their supports, they collapsed even faster than they went up.

John James Ingalls, of Kansas, describes what took place in that state about a generation ago:

> This feverish period culminated in a delirium of public and private credit known in local history as "the boom of 1887," whose frenzy and disaster have not been exceeded since the bursting of the "Mississippi bubble," or the collapse of the "tulipomania" of the seventeenth century.
>
> The building of superfluous towns, the construction of unnecessary railroads, the organization of counties, and the location of county seats, the entry of public lands for the sole purpose of mortgaging the inchoate title at excessive valuations, became established industries. The agents of Eastern companies eagerly

[1] Bryce, *The American Commonwealth* (revised ed.), vol. II, p. 901.
[2] *Ibid.*, p. 898.

competed for the privilege of placing loans upon quarter-sections without a fence or a furrow, often far beyond their market value. Professional "boomers," with a retinue of surveyors and cappers and strikers, invaded the state, bought and platted additions, which they sold at exorbitant prices to resident and foreign speculators, victims to the epidemic passion for sudden wealth, whose inexplicable contagion infected the reason of men with its undetected bacteria.

The reaction came like the "next morning" after a night of revelry and debauch. The plunderers disappeared with the ready money of the people, leaving, instead of anticipated wealth, an intolerable burden of maturing indebtedness upon deluded purchasers. Empty railroad trains ran across deserted prairies to vacant towns. Successive droughts and siroccos destroyed the crops in the western half of the state. The laborers, mechanics, and speculators, having erected costly business blocks that found no tenants, and residences that remained uninhabited, being without further occupation, sought employment elsewhere. The population declined. Payday came. The coupon matured. Taxes fell due. Creditors became clamorous. Merchants refused credit, and public and private treasuries were depleted.[1]

Kansas City, Omaha, Fort Worth, Minneapolis, and Wichita, Kansas, are notable examples of these speculative debauches.

Kansas City started off briskly in 1880, and by 1884 had begun to boom. Each year thereafter the boom increased in intensity, fury, and frenzy, until 1887, when the real estate business went to pieces like the giving away of an empty egg upon slight pressure.[2]

Speaking of Kansas City, Mr. Brown further says:

To the west of Main Street there was no business south of Ninth, yet in 1886 a tract of ground to the southwest of the business district, bordered on the east by Baltimore, on the west by Broadway, on the north by 17th Street, and on the south by 20th, sold at the average price of $6250 per lot and fully $750 per lot was necessary to cut down the limestone cliffs to grade. The nearest point to this tract was nine blocks to the then extreme

[1] *Writings, Addresses, and Orations,* pp. 478–79.
[2] Quoted from a manuscript of Elmer E. Brown.

southwest corner of the business district, and the average distance to the nearest point of the business district was twelve blocks. It was mountainous and the streets were nearly impassable. This tract did not again sell for as much, although Kansas City has doubled in population and has been wonderfully prosperous, until recently [about 1912] when the new Union Station was located within two blocks of it, since which time it has brought $7500 per lot. When one bears in mind that only horse-cars were then considered as means of transportation, except in the heart of the city where a couple of cabs were used, he sees to what extreme speculation had gone. In the heart of the city one piece of property sold so high that it never again recovered. The Junction at Delaware, Main, and Ninth was sold to a Mr. Thayer, of Boston, for $300,000. It was an outrageously high price for it considering that it consists of a point not equal in area to one lot, and of such a shape that a building of more than twelve stories would be impracticable for the reason that in making it higher too much space would be taken up with elevators.[1]

The boom at Wichita, Kansas, was one of the most remarkable in point of wildness and sudden collapse. A series of good crops in Kansas served to center the attention of the country on that state as a land of promise. Wichita was situated in the heart of one of the richest agricultural sections of the state, and to it the city-builders flocked. City additions extended far out on the open prairies. At length the boom degenerated into the buying and selling of town lots on a margin.

Finally values reached such a dizzy height that Murdoch himself [editor of the Wichita *Eagle*] saw the catastrophe ahead, and, without counseling with any one, he one night wrote a column article that appeared in the editorial department of his paper the next morning under the caption "Time to Call a Halt." He pointed out that, substantially, "one of these days two or three million dollars' worth of property will be dumped on the market, no buyer will appear, and the result will be bankruptcy to every one concerned." He indicated that there was no substantial basis for the wild speculations that were floating; that the bottom must drop out and disaster ensue. The effect of that one editorial was

[1] Quoted from a manuscript of Elmer E. Brown.

> electrical. Just what it predicted, it caused. The speculative game stopped instantly and liquidation was inaugurated. Within a few hours men who had calculated their holdings at millions under the inflated valuations found themselves penniless.[1]

It took Wichita twenty years to recover from this debauch. Since then her population has trebled, but she has not yet built up all the city additions laid out in 1887.

Our objective is the Oklahoma boom. The purpose of the foregoing description of the booms of a generation ago is to give a background, as it were, for the better understanding of the reappearance of the phenomenon in Oklahoma. The vital connection of this boom to the question in hand can scarcely be overstressed. The boom began to develop about the year the guaranty law was enacted and its collapse in 1911 and 1912 was followed by the long string of bank failures that have so grievously tried this first guaranty experiment.

The boom had its roots in the very beginning of Oklahoma history. Near the end of the last century most of the vacant land of the West had been taken up. When Oklahoma was opened to settlement the adventurous and enterprising from every state flocked in. The admission of the state to the Union gave it a national advertisement. The adoption of its constitution removed the uncertainty as to the attitude to investors, and foreign capital began to flow in. With the beginning of the twentieth century a veritable wave of prosperity was sweeping the country. Crop conditions were most favorable and the virgin soil of Oklahoma yielded most bounteously. Cities appeared overnight. Commercial and industrial enterprises, which in the older sections of the country had required generations in which to develop, sprang into existence in Oklahoma in a few short years. "Nothing succeeds like success" was the spirit which permeated the air, the result being that methods and processes were little questioned.

[1] *The Daily Oklahoman*, April 22, 1909, p. 8.

Oklahoma City is the commercial center of the state and the figures showing the precocious development of this city will suffice to show what was going on all over the state. Oklahoma City was founded April 22, 1889. Located in the center of the state it is on the dividing line between the northern and the southern elements of the state's population. In the opening of 1889, when the United States cavalry, at noon of April 22, gave way before the surging multitudes, the northerners rushed down from one side and the southerners dashed up from the other. The various town-site companies of these two sections came into conflict at Main Street, the most important thoroughfare of the city. In a few days the city had a population estimated at over four thousand. For the next ten years its growth was gradual, but between 1900 and 1910 it is said to have been the fastest growing city in the country. In this ten-year period its population increased from 10,037 to 64,205, or over 539 per cent. In 1907, when the state was admitted to the Union, the federal census showed a population of 32,452. Three years later the population was 64,205, or practically double. The question on every one's lips was whether it would double again in three years.

But this was a diseased growth. We now know that it was the result of that "hectic orgy of speculation" that swept so many towns off their feet in the granger states a generation ago. Old settlers of Oklahoma City, who have lived through the boom days of Kansas, are of one accord that what this city did in 1910 is exactly comparable to the Wichita of 1886 when that city was "full of supper and distempering draughts."

During this four-year period [1907–11] people gambled recklessly in real-estate futures. Few bought to improve. They bought to sell to some one else, again to some one else, and so on until the price reached a limit beyond which no one cared — or dared — to go. The last buyer was the loser. In some cases these last buyers, if they have held on till this time, will be able to realize at least a substantial part of the price they paid; in many

cases the properties are practically worthless and will remain so for years to come. . . . The town lots with which to gamble were supplied from the surrounding country. Schemes that now seem visionary to every one then looked like conservative development projects to the mind that had become accustomed to the rapid whirl of things.[1]

The following table giving the building permits and bank clearings for Oklahoma City shows vividly the course of events:

	Building permits [2]	*Bank clearings* [3]
1907	$1,853,629	..
1908	1,734,938	$46,182,000
1909	5,903,270	83,650,000
1910	5,493,203	122,821,000
1911	2,828,256	104,853,000
1912	885,246	85,415,000
1913	174,727	91,800,000
1914	1,972,442	115,880,000
1915	1,166,806	133,100,000

The table of building permits shows that there was nearly a fourfold increase from 1908 to 1909, reaching almost six million dollars. In 1910 the building craze was almost as intense. Then came the plunge downward, amounting in 1913 to less than $175,000. A great part of this building was done on borrowed capital. It is patent that when a city is growing in population from 32,452 to 64,205 in three years, there will be a very urgent demand for business houses of all descriptions as well as apartments and other dwellings. This demand was reflected in abnormally high rents. The natural consequence was that speculators borrowed money, erected buildings, with the expectation of having the margin between the interest charge and the rent pay for the structures in a few years. The speculator's early confidence in Oklahoma was well

[1] *Harlow's Weekly*, vol. II, no. 1, p. 809.
[2] *Annual Report*, City Auditor, Oklahoma City, June 1, 1916.
[3] *Harlow's Weekly*, vol. II, no. 1, p. 26.

founded, but this confidence soon waxed into recklessness. The city was temporarily built far beyond its supports, and when a period of depression passed over the state many of these speculators found "for rent" signs on their buildings and interest coming due at the bank. It has seemed most convenient to single out one city to show the details of this boom phenomenon. It should be borne in mind that every other city and town of the state was going through this same experience to a greater or lesser degree.

Attention must now be turned to what caused the boom to break. It has been noted that rich harvests in the granger states gave the initial impetus to the boom of 1887. It was protracted crop failures and thirty-cent wheat that rudely brought them to their senses. It is significant also that serious crop failures in Oklahoma turned the exhilarating period of 1907 to 1910 into the Slough of Despond of 1911 to 1913.

The following table shows the crop conditions in Oklahoma from 1906 to 1912.[1] In each case, except for hay and cotton, the figures represent the average number of bushels per acre. In the case of hay it is tons, and for cotton it is pounds per acre:

	1906	1907	1908	1909	1910	1911
Corn	33.3	24.4	24.8	17.0	16.0	6.5
Wheat	13.7	9.0	11.6	12.8	16.3	8.0
Oats	34.3	15.0	25.0	29.0	36.5	9.0
Barley	29.8	18.7	23.0	23.0	30.0	10.0
Rye	13.9	10.0	13.5	13.5	13.7	9.5
Potatoes	80.0	70.0	78.0	70.0	60.0	18.0
Hay	1.4	1.2	1.5	.9	1.1	.8
Cotton	217	200	143	147	200	160

This table shows three poor annual corn crops, culminating in that of 1911 with but 6.5 bushels per acre. This was a falling-off of 74 per cent from the crop of 1908 and 40 per

[1] *Year-Book of the Department of Agriculture*, 1914, pp. 511–78.

cent from the poor crop of 1909. The wheat crop of 1911 was 51 per cent short of what it was in 1910; the oats crop, 75 per cent; barley, 66 per cent; rye, 32 per cent; potatoes, 70 per cent; hay, 24 per cent; and cotton, 18 per cent.

The significance of this crop reversal can scarcely be overestimated. The great proportion of the population of Oklahoma was engaged in agriculture. In such a community the size of the crop represents the purchasing power of the people. The three years 1906, 1907, and 1908 show bumper crops all along the line. In these years Oklahoma was riding on the crest of the wave. It was a new country and its development called for a large outlay of capital. Farmers were buying farms, erecting buildings, purchasing farm implements, or expanding in other lines. This also increased the business of the merchant, the tradesman, and the dealers of all kinds, and this in turn stimulated commerce and transportation. Optimism pervaded the air, with the result that every occupation from that of farmer up was seeking a greater extension of banking accommodation. Then came the disastrous year of 1911. The purchasing power of the people was more than cut in half, with the result that the merchant or the banker who was carrying the farmer had to wait. This reversal would have been serious even under normal conditions, but Oklahoma, caught on the giddy heights of inflated values and credit expansion, "slipped down into the trough of the sea."

These crop failures precipitated a severe contraction in values. Not only had cities been overbuilt, but farm-land values were affected as well. Conservative real-estate men in Oklahoma estimate that the inflated values of 1910 had shrunk nearly fifty per cent by 1912 and 1913. It required five years to return to normal conditions. In this rapid recovery the state was fortunate, for many cities in the granger states were nearly twenty years expiating their follies of 1885 to 1887. The return of good crops, the rising

values taking place over the entire country, plus the resilient power of a rapidly growing state, all hastened the return to normal conditions.

With this view of the state's economic development before us as a background, we are now able to see how the banks became involved in this era of speculation. A quotation from the report of the Wisconsin banking committee will give a good idea of the manifold fields open to the speculator:

> The state is new and undeveloped. It is rich in its natural resources. It presents vast opportunities for the investment of capital, and is a land of promise for the speculator. It is rapidly increasing in population, and money from other states is flowing in at a rapid rate. Its citizens are comparative strangers to each other, business conditions have not become settled, and, generally speaking, reputations in the financial world for conservatism and financial probity have not been established. Oil fields and coal mines and many other propositions are still to be developed. Street railways remain to be built. Lighting companies are yet to be exploited and water works still remain to be established. It will thus be seen that alluring propositions constantly spring up, tempting investment by men of capital and the banker who has control of the trust funds of his depositors.[1]

Any situation in which a bank lends assistance to a speculator is fraught with great public danger. But the situation is doubly perilous if the banker is at the same time the speculator. It is where the anticipated profits are to be won by the banker himself that his judgment becomes most fallible. Regarding this, Mr. James B. Forgan, former president of the First National Bank of Chicago, says:

> I have seen many bank failures in the past thirty years, but all that I have ever known have had one and the same cause, namely, the management making loans directly or indirectly to itself. I have known incompetent bankers make heavy losses by bad

[1] *Report of the Special Committee on Banking,* Wisconsin Legislature, p. 7.

loans and lose their positions on that account, but I have never known a bank to fail or get into a failing condition where the officials had no personal interest in the loss.[1]

If proof were needed that the banks became involved in this speculation, it would only be necessary to rehearse again the sordid story of the bank failures. The details of these failures have already been set forth. It is sufficient here to reëmphasize the fact that they all tell the same story — a welter of oil speculation, town-site promotions, and honest incompetence, followed by a shrinkage of values, absconding and suicide of bank officials, and far too few jail sentences.

After it is all over it is easy to see how these banks were caught. With the development of the boom credit became unduly extended and this expansion of credit was pyramided upon the bank. Much of this credit had directly or indirectly a real-estate foundation. When a boom is on the upward swing real-estate loans are a liquid asset, for real estate will then change hands as easily as war stocks. When the reverse movement comes and the boom hits its trough, so to speak, real estate is the most unliquid of assets. The depression has snuffed out the anticipated profits from this source and no one will touch it. Thus the banks, with demand liabilities staring them in the face, found a mass of unliquid assets, shrunk in value, on their hands. There could be but one result. The state had permitted too much incompetent banking for the ordinary bank to stand the strain and a crash came.

We have now seen the economic forces operating to effect the downfall of banks. To make the story complete we must revert again to politics and weave in the political threads that have so colored this initial bank-guaranty experiment.

The State of Oklahoma as now constituted is the result of the artificial welding of the two dissimilar civilizations

[1] *Bankers' Magazine* (N.Y.), 76:224.

of Oklahoma and Indian Territories. As already pointed out [1] Oklahoma Territory possessed a general banking law and at least a semblance of banking regulation. But such was not the case with Indian Territory, where banks were not even required to incorporate. Such were the conditions at statehood, and four weeks later Oklahoma's now famous bank-guaranty law threw a blanket insurance over these banks. The banks were examined as already described, with the remarkable result that they all passed the examination. We now know that at least a year should have been spent in coaching many of these banks into a solvent condition. But the proponents of bank guaranty were far too impatient for any such delay, and they dared not antagonize the individualistic tendencies of these private bankers by an unflinching enforcement of the law. The result was that many of these territorial banks entered the guaranty system with their solvency in doubt. The events which followed greatly increased the harm this might do. Bank guaranty was already in politics, but it was now to sink deeper, for six months later it was made a prominent issue in the forthcoming national election. This had an unfortunate effect, for all through the campaign the Oklahoma law was the cynosure of the nation. It will be remembered that at this time the state banking board consisted of the principal state officials who had been instrumental in enacting the law. This board felt that a rigid enforcement of the law would antagonize the banking fraternity and make the idea unpopular on the eve of the national election. The campaign also unduly advertised the law, the result being that the deposits of the guaranteed banks more than doubled the first year. In this way the demands of politics thwarted the strict enforcement of the law, while at the same time the law was greatly expanding the deposits of both sound and unsound banks, thus adding fuel for speculative purposes.

[1] See pages 37–40.

It is worthy of note that since the enactment of the guaranty law not one national bank has failed in Oklahoma that has occasioned a loss to depositors. The oil plunging of W. L. Norton caused an embarrassment to the Farmers' National Bank of Tulsa and the American National Bank of Bartlesville — two banks in which he was personally interested. The Farmers' Bank was forced to suspend, but later paid out dollar for dollar. Norton was sentenced to serve seven years in the United States penitentiary for making false records in the books of the American National Bank of Bartlesville.[1] On October 31, 1919, the First National Bank of Hobart, Oklahoma, was closed, but there was no loss to depositors. This record of the national banks is in striking contrast to that of the state banks for a period after the enactment of the guaranty law. The national banks, under the supervision of the United States Government, were saved from the mire of Oklahoma speculation. The state banks, corrupted by the disease of political expediency, were swept off their feet by the first adverse wind.

When the system began to break the hesitating policy of the state banking board was still further in evidence. The board, feeling the political necessity of making the scheme a success, resorted to all sorts of means to bolster up the tottering system. The law was plain. The duty of the board was strictly to enforce the law, and, should a failure occur, take charge of the bank and pay the depositors. Instead of doing this the board tried to anticipate failures and by the use of the guaranty fund to tide them over. In some cases it took money from the guaranty fund and made deposits with banks in a failing condition. In other cases it used the fund to buy securities from failing banks. For ten months prior to the failure of the Planters' and Mechanics' Bank of Oklahoma City the board had been both making deposits with and buying securities from it, only in the end to see it

[1] The sentence was commuted to a year and a day for good behavior.

go under.[1] The money thus deposited was not only lost, but the whole loss of the subsequent failure had also eventually to be met. When the guaranty fund gave out the board borrowed money by means of the sale of interest-bearing warrants for the purpose of continuing this questionable policy. The excuse of the board was that this temporary assistance would enable the bank to stem the tide and thus save the fund the much greater loss incident to the closing and the liquidation of the bank. But almost without exception the bank had ultimately to be closed. This policy was clearly beyond the intention of the law and has now been abandoned.

This account of the Oklahoma experiment shows that it has been the victim of the combined operation of many unfavorable forces. The first difficulty in the way of success was that the early propagandists, flouting the inexorable laws of scientific insurance, tried out the scheme on banks, many of which emerged from the territorial régime in an unsound condition. The insidious working of politics prevented these unsound banks from being brought into conformity with the law or else forced out of business. The guaranty law removed the necessity of the depositor's giving careful scrutiny to the strength of the bank that he patronized, with the result that the deposits of the unsound banks grew as rapidly as those of the sound ones. Oklahoma was a rapidly developing country and this joined to lax banking morals ended in wild-cat banking. Serious crop failures put a damper on the Oklahoma boom and when the reaction set in many of these speculative banks were unable to stem the tide. These various forces, acting and reacting on one another, brought the Oklahoma system at one time to the very threshold of destruction. The proponents of bank guaranty could scarcely have chosen more unfavorable conditions under which to experiment and the miracle is that the breakdown was not complete.

[1] *Quarterly Journal of Economics*, 1913, 28:30.

In September, 1914, the guaranty fund was $807,475.09 in debt. For a time it seemed highly improbable that the system by its own exertion would be able to extricate itself. Governor Cruce recommended to the legislature of 1913 a general tax levy to assist in wiping out the indebtedness of the fund. In urging such action he said:

> The purpose of the enactment of the law was first to make secure to the individual the payment of his deposit; second, and in a much broader sense, it was to enforce stability in financial affairs in this state. While the man who places his money in the bank is primarily protected by having his money returned to him — every man in the state is indirectly benefited by having a condition prevail in financial circles that will prevent a tightening of credits and permit business to flow in uninterrupted channels. The benefit that the banker gets is in this larger way, for bankers, like all business men, are vitally interested in the stability of commercial conditions. The banker also profits in the fact that greater confidence has been inspired among the depositors in his institution, thereby increasing the amount of his deposits; but since the benefits of this law are so universally distributed and so far-reaching, is it fair that all the burdens, from which flow these benefits, should rest upon a single class of individuals? I think not. I believe that this burden should, in a measure, be borne by the general public, since the general public is a large beneficiary of the law. I believe that a tax upon the average daily deposits of banks should be levied each year and that the amount should be fixed and certain, so that the banker may know what his liabilities in the way of taxation may be. This fund should be used for the purpose of liquidating deposits in state banks; and if this fixed tax should fail in the future to be sufficient to meet the payment of deposits of failed state banks, then the residue should be borne by the state. This would make the enforcement of the criminal provisions of the law much easier.

Notwithstanding the influence of the governor, the bank commissioner, and the banks, little enthusiasm was evinced in favor of any state assistance. Almost a fourth of the total vote of the state has on occasions shown socialistic tendencies and the Jacksonian suspicion of banks and banking operations is too widespread to hope for any relief

from a general tax levy. Seven years ago, when this proposal of a general tax levy was being seriously considered, the situation was at its most gloomy stage. Since then general conditions over the state have greatly improved and the revamped guaranty system and the general banking laws have had time to work out far-reaching reforms. At the present time the guaranty system has completely regained its feet and the future continues to grow more hopeful.

The reconstruction of the state banking department has produced most salutary results. It will be recalled that the state banking board is now appointed by the governor from a list nominated by the state bankers themselves. This has completely divorced the board from politics. Mr. J. D. Lankford, who served as bank commissioner from 1911 to 1919, organized a most efficient bank supervision. This department is indefatigable in ferreting out incompetent and reckless banking. The state, in the words of the bank commissioner, has rapidly emerged "from what would be termed a state thoroughly infested with financial criminals and incompetents, with lax laws and but little execution of same, toward leadership in all that is clean, practical, and right in banking, as well as in good citizenship." [1] General economic conditions have also become quite similar to those of older states. It seems fair to assume that certain events of pioneer days will not be repeated — at least, no other state has repeated them. This fundamental change in conditions in conjunction with the rigid and watchful supervision of banks should keep future losses within a reasonable limit. Finally, the most gratifying feature of the present situation is the condition of the guaranty fund. On September 30, 1914, this fund was in debt to the amount of $807,475.09; by December 31, 1916, this had been reduced to $666,378.51; while on March 1, 1920, this indebtedness was not only liquidated,

[1] *Fifth Biennial Report of the Bank Commissioner*, letter of transmittal.

but there was also $75,000 in the treasury. Another assessment is due which will add $275,000 to this amount, and the banking board holds assets conservatively valued at $50,000. This means that the guaranty fund at the present time amounts to about $400,000. It is patent, therefore, that the year 1919 witnessed the lifting of the pall that settled over the state bankers in 1909 to 1913. It has been a long, hard pull, and hardly any one seven years ago would have said that it could be done.

Thirteen years ago the people of Oklahoma rushed cavalierly into bank guaranty, but the heartrending events since that time have profoundly sobered them. "We were right in principle" is the universal comment in the state, but the average citizen "seems half ashamed and half amused" when he reflects on the incongruity of choosing the Oklahoma of 1907–12 as the laboratory in which to perform the experiment. Because of the importance of the principle involved, and because of the dramatic incidents attending the experiment, this episode will ever prove an absorbing chapter in American financial history.

CHAPTER IV

THE KANSAS SYSTEM

1. *Conditions antecedent to the guaranty law.* The part taken by Kansas in the early movement for bank guaranty has already been touched upon. The explanation of this early agitation in Kansas can only be found in an examination of the conditions through which that state was then passing. In the early eighties a conjuncture of auspicious events served to give the impetus to the boom which swept over that and neighboring states. This boom attained its maximum intensity in 1886–87. Then came a long series of crop failures at a time when the price of farm products had sunk below the cost of production. On top of this affliction came, a few years later, more lean years and then the trying national depression of 1893. In the face of this reversal the boom collapsed like a punctured bubble and for years Kansas was prostrate. In 1891 Kansas passed a general banking law, and for the first time the banks of that state came under regulation.[1] Prior to the enactment of this law the banks were of a private nature, most of them being in the form of real-estate companies. These loan companies had become deeply involved in the boom, and when the days of adversity came they found themselves loaded down with unprofitable and unsalable real estate and other securities. The result was that in the six-year period of 1892–98 seventy-five state banks suspended in Kansas.[2] In the decade from 1890 to 1900 thirty-two national banks failed in the state with a net loss to depositors of over nine hundred thousand dollars.[3]

This protracted period of depression crystallized the Pop-

[1] *Second Biennial Report of the State Bank Commissioner*, p. iii.
[2] *Second, Third,* and *Fourth Biennial Reports of the State Bank Commissioner.*
[3] *Report of the Comptroller of the Currency*, 1915, vol. II, pp. 114–17.

ulist movement. The Populists had great faith in the efficacy of legislation in moulding economic conditions and they made bold to carry their convictions into effect. To relieve the low price of agricultural products they called for the immediate doubling of the currency of the country. To them the railroads were a monstrous octopus absorbing the profits of the farmer; hence they demanded government ownership of railroads. It is but natural, therefore, that when one hundred and seven bank suspensions occurred, with all the distress and hardship which they entailed, there should be agitation for remedial legislation. Consequently we find the guaranty of bank deposits as an embryonic idea taking shape in the minds of many men of that period.

Representative F. P. Gillispie, described by Charles Sessions as a "long-whiskered but keen-minded Populist," introduced in 1897 the first bank-guaranty bill in Kansas.[1] John W. Breidenthal, the Populist bank commissioner, in his Report of 1897–98, said in urging a guaranty law:

> For years I have looked forward to a time when the state could adopt such a requirement with safety, and with the assurance that its adoption would prove a success. I have not heretofore recommended the creation of a guaranty fund for the very good reason that it was first necessary that all banks doing business in the state should have a general house-cleaning, that all bad results of the boom period be eliminated and all impairment of capital be made good.[2]

Mr. Breidenthal then outlined in detail the provisions of his contemplated guaranty law. In the election of 1898 the entire Populist state administration was defeated by the Republicans. However, before relinquishing control to his successor Governor Leedy called a special session of the legislature in a last desperate effort to get a guaranty law. A bill drafted by Bank Commissioner Breidenthal was

[1] *Topeka Daily Capital*, September 5, 1909.
[2] *Fourth Biennial Report of the Bank Commissioner*, p. xvii.

introduced into the legislature. The bill "required state banks to donate either one eighth of one per cent of deposits to a guaranty fund or turn over to the state treasurer five per cent of their deposits, the interest on which was to go into the guaranty fund." [1] This is the bill, previously referred to, that passed the State Senate, but lacked four votes of passing the House of Representatives. Mr. Sessions says that the opponents of the bill referred to it as "one more crazy notion of the Pops," while the Populists themselves attributed their defeat to the fact that they were "ten years ahead of the times." [2]

One week later the Populists gave way to the Republicans and Stanley, the new governor, in the course of his first message said:

> The bank commissioner recommends the creation of a guaranty fund for the protection of bank depositors. No one thing connected with the business of banking would be more desirable than some proposition securing the safety of depositors. The plan proposed is new; it may be practical. I recommend it to your careful consideration.[3]

This suggestion met no response in the legislature, and since the governor pressed the matter no farther, bank guaranty gave place to other things. In the meantime Kansas was beginning to experience wonderful prosperity. Abundant harvests, rising prices for farm products, and nationwide prosperity wrecked the Populist movement. The banks were also sharing in the good times and failures were almost unknown. Before this rising tide of prosperity bank-guaranty agitation gradually melted away and for ten years was forgotten.

Soon after the Oklahoma law was passed the idea began again to attract attention in Kansas. Some of the smaller banks, especially those in the southern part of the state near the Oklahoma state line, began to importune the state administration for such a law, as they feared that the guar-

[1] *Topeka Daily Capital*, September 5, 1909.
[2] *Ibid.*. [3] *Ibid.*, January 13, 1909.

anteed banks of Oklahoma would attract Kansas deposits. Some of the Oklahoma banks were advertising over the country, and even in foreign countries, that their deposits were guaranteed by the guaranty fund. The presidential election was also greatly advertising the Oklahoma system. This caused some of the Kansas banks to feel that the Oklahoma law placed them under a serious handicap, and they began to agitate for a similar statute in Kansas.

This resulted in a serious attempt to enact such a law. The panic, the Oklahoma example, and the agitation on the part of some of the banks, caused Governor Hoch to call a special session of the legislature to meet January 16, 1908, to consider such legislation. Hoch was a Republican, but a sincere believer in bank guaranty. In 1905, when he first took office, he led the crusade that resulted in the Kansas legislature appropriating money to establish a state oil refinery to break the monopoly of the Standard Oil Company in that state. This law was soon after declared unconstitutional by the State Supreme Court. It was natural, therefore, that Hoch should be favorably inclined to the guaranty idea when it began to attract public attention. The special session of the legislature began its work and the Quincy bill was brought forward as embodying the ideas of the friends of bank guaranty. But the national banks and the other opponents of the proposition developed powerful opposition to the measure, and this opposition under the leadership of B. P. Waggener, of Atchison, the astute attorney for the Missouri Pacific Railway Company, started in to cripple the bill. The bill was now loaded down with ridiculous amendments, such as requiring unlimited liability of stockholders of guaranteed banks, until the friends of the measure moved the suspension of its further consideration.

To appease the popular demand for guaranty legislation Waggener now brought forward a remarkable proposition. His bill permitted any person who was so inclined to organ-

ize a private insurance company with a capitalization of a million dollars for the purpose of insuring bank deposits. Of course the state laws already permitted the organization of such a company, and the governor, considering this subterfuge so preposterous, vetoed the bill, saying that it was better to wait until a law based on right principles could be passed.

This legislative fiasco occurred nearly six months prior to the Denver Convention. In the meantime political expediency greatly altered the local situation in Kansas. The Democratic National Convention at Denver had adopted a bank-guaranty plank, thus automatically forcing the Republican national organization into a position of opposition. But the Kansas Republicans refused to sanction the position taken by the national organization on this question. When the Republican State Council met in Topeka, in July of 1908, Bristow and Stubbs were in control. Bristow was seeking the nomination for the United States Senate at the forthcoming primary election, and Stubbs the nomination for governor. Both of these gentlemen frankly admitted that it would be folly for the Kansas Republicans to play into the hands of the Democrats by giving them a monopoly on such a popular vote-getter. Consequently under their leadership the Kansas Republicans went on record as favoring the guaranty of bank deposits, and pledged the enactment of such a law if they were returned to power at the November election. Both parties, therefore, went before the people pledged to support such legislation.

2. *The law and its amendments.* At the November election the Republicans were successful, and the new legislature met in January, 1909. Both parties having been pledged to support such legislation the principal interest centered in the nature of the law which would be enacted. The partisan discussion and criticism to which the Oklahoma law

had been subjected proved instructive to the Kansas legislators and they adopted a law which was a radical departure from the basic principles of the Oklahoma plan.

In the first place the system is voluntary. Each bank is free to choose its own course, and the action of one bank is sufficient to set the plan in operation. Such a plan silences the objection raised against the Oklahoma system, that honest banks are required to help pay the debts of the dishonest. The second distinguishing feature of the law is that it makes no attempt to pay depositors at once. When a bank fails the bank commissioner issues to each depositor a certificate of indebtedness bearing six per cent interest, and as soon as the assets of the failed bank are realized upon the funds so obtained are applied to the payment of these outstanding certificates. But the depositor really gets the equivalent of cash, for these six per cent certificates are gilt-edged securities and the other banks are eager to cash them both for the sake of the certificates themselves and in the hope of attracting a new depositor. But the fact remains that the guaranty law itself makes no promise of immediate payment. These are the two dominating characteristics of the Kansas plan, and they are of such far-reaching importance as to place bank guaranty in Kansas on an entirely different basis from that upon which the Oklahoma system rests.

The Kansas law permits any incorporated state bank having a paid-up and unimpaired surplus equal to ten per cent of its capital stock to take advantage of the benefits of the depositors' guaranty fund.[1] Each bank, before it becomes subject to the operation of the law, is subjected to a rigid examination. If this examination is satisfactory the bank is required to deposit with the state treasurer, as an evidence of good faith, an amount equal to $500 for every $100,000 of deposits, less its capital and surplus. This deposit may be in the form of cash, or national, state, or

[1] *Kansas Bank-Depositors' Guaranty Law*, section 1.

municipal bonds.[1] Upon meeting these requirements its assessments begin, and the bank is given a certificate by the bank commissioner stating that its deposits are protected by the guaranty fund.

Since there is no attempt to pay depositors at once the size of the fund which is created needs only to be sufficient to meet ultimate loss. The law provides that the annual assessment levied on each bank shall be one twentieth of one per cent of average deposits, but in computing the amount of these deposits the bank is permitted to subtract the amount of its capital and surplus.[2] This last provision is held out as an inducement to the accumulation of capital and surplus. However, in each case the assessment must be at least $20. This annual assessment continues until the fund reaches $500,000, after which it is discontinued until the fund falls below that amount. In the event of the fund becoming depleted the bank commissioner levies such additional assessments as are necessary, but in any one year there cannot be more than five assessments of one twentieth of one per cent of deposits. The state treasurer holds this fund in the state depository banks subject to the order of the bank commissioner.[3]

In case of insolvency the bank commissioner takes charge of the bank and proceeds to liquidate the assets. As soon as possible he issues to each depositor an interest-bearing certificate. The rate of interest on these certificates is six per cent unless the deposits for which they are issued bore interest at a contract rate, in which case the certificates bear interest at the contract rate. As soon as the assets of the failed bank are realized upon these certificates are paid off. If sufficient is not realized to cancel the certificates the bank commissioner certifies to the state treasurer the balance yet due, and the state treasurer then pays this balance from the guaranty fund.[4]

[1] *Kansas Bank-Depositors' Guaranty Law*, section 2.
[2] *Ibid.*, section 3.
[3] *Ibid.*.
[4] *Ibid.*, section 4.

The law being voluntary a bank is permitted to withdraw from the guaranty system should it so desire. But any bank so withdrawing is required to pay its quota of assessments that are made to pay losses from bank failures occurring within six months after the date of its application to withdraw. When the retiring bank has met all the requirements of the law the state treasurer returns to it the deposit of cash or bonds held by him as an evidence of its good faith.[1]

When the guaranty law was passed in 1909 the legislature at the same time amended the general banking laws, making more stringent regulations to guard against loose banking. The law has established a relationship between deposits and capital and provides that the deposits of guaranteed banks shall not exceed ten times their paid-up capital. If a bank exceeds this limit for as long as six months its charter is revoked.[2] The law limits the rate of interest which a bank may pay on deposits that are subject to the guaranty law, and an officer who promises to pay a higher rate is guilty of a misdemeanor.[3] Advertising in such a way as to imply that deposits are guaranteed by the State of Kansas, or advertising which implies that the bank is a member of the guaranty system when it is not, is a misdemeanor.[4] If upon examination a bank is found to be violating the law it is given thirty days in which to comply with the statutes. If at the end of this time it is still out of harmony with the law it loses its membership in the guaranty system and forfeits to the guaranty fund the cash or bonds which it has on deposit with the state treasurer.[5] The law governing the residence of directors and the amount of stock which bank officials must hold was also made more strict, and if the bank commissioner finds a bank official who is incompetent, reckless, or dishonest, he must order the bank directors to remove such official.[6]

[1] *Kansas Bank-Depositors' Guaranty Law*, section 5.
[2] *Ibid.*, section 14. [3] *Ibid.*, section 7. [4] *Ibid.*.
[5] *Ibid.*, section 11. [6] *Kansas Banking Law*, section 59.

The law offers no incentive to a mushroom growth of new state banks that seek the prestige of the guaranty system to draw deposits. The Oklahoma law was defective in this respect, with the result that the state for a time was burdened with a superfluity of struggling banks. In Kansas a bank cannot enter the guaranty system until it is a year old, and then it must have a paid-up and unimpaired surplus equal to ten per cent of its capital stock, unless there should already be no guaranteed banks in the same town.[1]

Since the passage of the law in 1909 two important changes have been found necessary. Originally the law restricted the deposits that were subject to guaranty to those not bearing interest, to time certificates bearing interest at not more than three per cent, and to savings accounts of not over one hundred dollars to any one person. But now all deposits not otherwise guaranteed are permitted to be protected by the fund. The second change was in regard to the rate of interest which might be paid on guaranteed deposits. At first this was limited to three per cent, but this proved to be too great a handicap on the guaranteed banks. The economic needs of the various parts of the state differ, so the law as amended allows the bank commissioner to fix the rate which may be paid. This has been done and the rate now ranges from three to five per cent.

The Kansas law permitted the national banks of the state to participate in the benefits of the system provided they met the requirements of the state law. But Attorney-General Wickersham took the same position which Mr. Bonaparte had taken in the Oklahoma case, ruling that a national bank had no corporate power to submit to state regulation and that only an act of Congress could confer upon it such power. As in Oklahoma this decision was bitterly resented by the national banks, for they feared the competition of the guaranteed state banks.

Almost immediately after this ruling of the Attorney-

[1] *Kansas Bank-Depositors' Guaranty Law*, section 1.

General a movement was started by the national banks to form a private bank-deposit insurance company to counteract the influence of the guaranty law. Mr. Wickersham held that there was no legal objection to such a course, so in May, 1909, the Bankers' Deposit Guaranty and Surety Company was formed, with a capital of $500,000, and having headquarters at Topeka. The stock of this company was to be held by officers of national banks of the state and of those state banks that did not enter the guaranty system. The company was to issue policies to each member bank insuring its depositors against loss in case of failure. No banks are accepted by this company until after they have been a going concern for at least a year. Premium rates were fixed at fifty cents for each thousand dollars of deposits up to the amount of the capital and surplus of the insuring bank. The rate above this amount was to be one dollar for each thousand dollars of deposits.[1] This company attracted wide attention at the time and was hailed by many as the most equitable solution to the problem of protecting deposits. About one hundred banks became members of the company. Although the company sustained no losses the enthusiasm of the movement soon died out. After ten years about two thirds of the banks that originally protected their deposits in this manner are continuing their insurance. Of the banks carrying this insurance about one out of four are state banks.[2] The national banks have long since ceased to fear any special competition from the guaranteed banks with the result that few of them feel the need of this insurance as an advertising feature, and many that insured their deposits ten years ago have permitted their policies to lapse. The company is now confining its activities in large part to a bonding and allied business.

The Kansas law also got into the courts. The Abilene

[1] *Quarterly Journal of Economics*, 1909, 24:349.

[2] Letter from the secretary of the company.

National Bank, of Abilene, Kansas, instigated proceedings to prevent the state officials from enforcing the law, the contention being that it was unconstitutional. Judge J. C. Pollock, of the United States Circuit Court, upheld this contention, saying that the law violated the Fourteenth Amendment to the Federal Constitution in that it conferred special privileges upon certain classes. The case was appealed, and on May 20, 1910, Judge W. C. Hook, of the United States Circuit Court of Appeals, reversed the decision of Judge Pollock, saying that there was no merit in the contention of the Abilene Bank. The case was then appealed to the United States Supreme Court. The state banks that did not want to operate under the law, headed by the Assaria State Bank, of Assaria, Kansas, asked for an injunction to restrain the state officials from enforcing the law. They claimed that they did not want to participate in the guaranty system, but that while the law was voluntary in letter it was compulsory in spirit, since business policy would force the banks into the system. They therefore maintained that the enforcement of the law would be an unjust discrimination against them. Judge Pollock refused to allow the contention and the case was appealed to the United States Supreme Court. On January 2, 1911, this court combined these two Kansas cases, considered them in connection with the Oklahoma and Nebraska cases, which were also before the court, and upheld all three laws.

3. *Bank failures.* Since the law went into operation the guaranty fund has sustained three losses. Two of these failures are so recent that at the time this is being written (May, 1920) practically no information is available except press reports, but it is possible that when the losses of these banks are made good the guaranty fund will be in large part or wholly wiped out. The first failure was that of the Abilene State Bank, of Abilene, Kansas, which was wrecked in September, 1910, through the embezzlements

of John A. Flack, its cashier. The guaranty law was in no way responsible for this failure. The bank failed for no other reason than the flagrant dishonesty of this official — a type of dishonesty that has manifested itself many times in the past. For three years Flack secretly played his game — now filching, now boldly robbing — running the gantlet of all known ways of stealing from a bank. To keep up the bank's deposit account he paid six per cent interest in some cases to hold deposits, paying this interest out of the bank's cash, yet leaving no records for the directors.[1] To get money he forged names.[2] In one case he took $5000 from the bank and charged it to his own account by note, yet no record was found of any such note.[3] He removed mortgages from safe-deposit boxes and placed them in with the assets of the bank.[4] In order to hide his transactions Flack used a loose-leaf ledger and kept his books in balance by removing leaves. Flack kept one of the most expensive homes in Abilene and was a royal entertainer. He was active in all good work of the city, and, largely because of a personal charm, was a man whom every one delighted to honor. When Flack found it was no longer possible to avoid detection he fled the state and spent two years in New York City dodging detectives. After being at liberty for two years he was caught, returned to the state, tried, convicted, and sentenced to the state penitentiary. I. S. Hallam, the president of the bank, collapsed soon after hearing of Flack's absconding and died a few days later. Two other deaths were said to have been caused directly by the wrecking of this bank.

As soon as the bank closed interest-bearing certificates were issued to depositors as provided by law. The other Abilene banks bought up these certificates at once, for they were eager to get the patronage of the depositors of the defunct bank. In July, 1912, there were $40,408.48 of these

[1] *Abilene Weekly Reflector*, September 15, 1910, p. 1.
[2] *Ibid.*. [3] *Ibid.*. [4] *Ibid.*.

certificates outstanding and assets in the hands of the receiver amounting to $97,526.96.[1] In the process of liquidation many of these assets proved bad, and when on November 22, 1913, the affairs of the bank were finally closed it was necessary to draw on the guaranty fund to the amount of $28,701.76.[2]

The second failure to occur in Kansas was that of the Kansas State Bank, of Salina, Kansas, which was closed in May, 1919. It is probable that this failure will cost the guaranty fund from a quarter to a half-million dollars. This bank had been practically insolvent for some time, but it was finally wrecked by Felix Broeker and H. J. Lefferdink, the latter the bank's cashier, in their attempt to purchase a New Mexico ranch.

> For the ranch and for the cattle Lefferdink and Broeker were to pay in the neighborhood of $400,000. It was reported that investigators for a well-known Kansas trust company had been sent to New Mexico to appraise the ranch and that its report was as flattering as the printed prospectus of the land agents had made the place appear. The ranch and the stock and the "belongings" thereof were put down in black and white by the financial experts as being worth not one cent less than $1,200,000. The purchase of the ranch at $400,000 was accepted as a bargain. The possibilities of the land from a financial standpoint were fairly staggering. It could be capitalized at a million dollars and bonded at one half million dollars. The sale of the half-million in bonds could be used to pay for the ranch, with $100,000 clear for the promoters.[3]

The initial payments on the ranch were made by the issuance and sale of four certificates of deposit each to the amount of $25,000. A second payment amounting to $125,000 was made by Lefferdink, the cashier, giving his own note to the bank and using this amount of the bank's funds. It was expected that the sale of the bonds issued on the ranch would furnish funds with which to pay the cer-

[1] *Eleventh Biennial Report of the Bank Commissioner*, p. 8.

[2] *Twelfth Biennial Report of the Bank Commissioner*, p. 9.

[3] *The Kansas City Star*, October 24, 1919, p. 10.

tificates of deposit and the note when they became due. When these instruments began to fall due no funds had yet been realized on the sale of the bonds, and Lefferdink, in order to get funds, issued twenty-five sight drafts each to the amount of $5000. About this time the bank commissioner stepped in and the crash came. Lefferdink escaped and the banking department was left to straighten out the mess. When the department began an investigation to see how far the ranch would protect the bank, it was found that the cattle on the ranch had been driven off and sold to satisfy a mortgage and that there was a mortgage against the ranch to the amount of $154,000, which was reported to be about fifty per cent in excess of the value of the ranch.[1]

The amount that is owed the bank by its officers and men closely associated with the officers is $448,000. Of this amount Felix Broeker is charged with $146,784; H. J. Lefferdink, $224,105, of which amount $60,000 is an overdraft; and E. J. Guilbert, the president of the bank, $42,392. The total that is owed the bank by all persons is $595,000.[2]

It is of interest to examine some of the methods this bank used in collecting deposits.

> One Salina business man was offered a bonus of $5000 to carry a deposit in the Kansas State Bank for 120 days. A Claflin banker made two deposits of $10,000 each in the Salina bank and received a cash bonus of $1000 on each deposit.[3]

In regard to these methods and the necessity of dealing with them, Governor Allen said:

> The Salina failure has presented a situation not foreseen by the state legislature. It shows the absolute necessity of statutory provisions which prohibit the campaign for funds by unscrupulous bankers. When a bunch of crooked speculators get control of a bank and offer a bonus for deposits under the argument that

[1] *The Kansas City Star*, October 24, 1919, p. 10.
[2] *Ibid.*, June 4, 1919. [3] *Ibid.*.

the depositor can lose nothing since the bank funds are guaranteed, it is high time for the legislature to take some action.

This situation has proven that in one instance, at least, the opponents of the bank-guaranty act were good prophets. Their argument was to the effect that unscrupulous bankers would take advantage of the fund. That is just the thing which seems to have happened at Salina.[1]

At the present time little progress has been made in straightening the affairs of this bank. The depositors were given interest-bearing certificates which will not be paid until the assets are liquidated. The Attorney-General began an ambitious programme of prosecuting any one criminally liable, but to date he has had little success. He has complained bitterly that the citizens of Salina have given him little assistance. The reason for this seems to be that many of them are resentful at the banking department, and the further fact that the affairs of the Salina bank touch the business life of so many Salina people that they do not relish the advertising incident to a spectacular trial. The great difficulty, however, is that Lefferdink made good his escape and there seems to be a tendency on the part of many to shield themselves by unloading the guilt on to him.

The third loss to the guaranty fund was caused by the failure of the Aulne State Bank, Aulne, Kansas. This bank was closed in May, 1920. V. O. Johnson, the bank's cashier, confessed to the embezzlement of $86,000 of the bank's funds. Johnson used these funds to develop a stock farm on which he maintained a large herd of registered cattle and on which he had built a $20,000 home. This project failed to pay because of the break in prices of cattle and the high cost of feed and farm labor.[2]

According to the bank commissioner Johnson's defalcations have extended over a period of four years and were very similar to those utilized when the Abilene State Bank was wrecked more than eight years ago. . . . It was said that Johnson's defalcations were successfully covered up by the use of loose-leaf bookkeeping,

[1] *The Kansas City Star*, June 4, 1919.

[2] *The Weekly Kansas City Star*, May 19, 1920.

and that the cashier personally carried time deposits instead of placing them on the bank's accounts. According to the statement Johnson destroyed ledger sheets and juggled certificates of deposit records in order to cover up the shortage.[1]

Since this failure occurred but a few days before this is being written it is impossible to give any estimate of the net loss.

Another Kansas bank failure that is of interest is that of the Hanover State Bank, of Hanover, Kansas. This bank was also closed in May, 1920. The Hanover State Bank was not operating under the guaranty law and for that reason the failure is of interest principally because of the manner in which the bank was wrecked. August Jaedicke, the president of the bank, admitted in a letter to the banking department that he had embezzled $138,000 of the bank's funds. In addition to this it is probable that he has misappropriated approximately a half-million dollars of the funds of his friends and neighbors who had left bonds and other securities with him.[2]

This makes three banks in Kansas that have been wrecked within a year by the embezzlements of their officials. This has led to bitter attacks on the banking department, charging it with gross negligence and inefficiency. However this may be, it was well known that the Salina bank had been in a precarious condition for years. This bank, operating originally under another name, became in such a condition that the management had to relinquish control and the bank was reorganized by other parties. Certainly in this case at least there was sufficient warning for every one, including the banking department, to be on guard.

4. *The effects of the law on the state and the national banks.* The next thing of interest is to watch the effect of these failures on the guaranty system of the state. The loss to the guaranty fund will be heavy, and it remains to be seen

[1] *The Weekly Kansas City Star*, May 19, 1920. [2] *Ibid.*, May 26, 1920.

what effect this will have on the other banks and on the depositing public. Participation in the system being voluntary the losses may cause the member banks to forsake the system, while, on the other hand, the effect on the public may be such as to compel practically all the state banks to come under the law. In Oklahoma heavy losses caused the larger state banks to defy public opinion and nationalize; in Nebraska bank failures caused quite a number of national banks to incorporate under the state laws and guarantee their deposits. Two of the defunct Kansas banks have been closed less than a month and it is too early to determine what may be the effect.

The law went into operation June 30, 1909, and at once many state banks began to avail themselves of its privileges. By the end of September, 1909, 300 banks had enrolled and were protected by the guaranty fund.[1] In September, 1912, 456 banks were operating under the law, while on November 15, 1919, there were 649 guaranteed banks and 443 unguaranteed.[2] These figures show that the growth of the guaranty system, while steady, has not been startling. The fact that only a little over half of the banks are operating under the law, at a time when the assessments have been so extremely light, shows that there is no great public interest in the law. It is significant, however, that the total deposits of the guaranteed banks are nearly two and one half times those of the unguaranteed. On the face of it this might seem to indicate that the law has had a marvelous power over deposits, but the truer explanation is that it has been the larger banks that have gone into the system. Another thing which goes a long way in explaining the small total deposits of the unguaranteed banks is the fact that under the law a bank must be one year old and have a paid-up and unimpaired surplus of ten per cent of

[1] *Quarterly Journal of Economics*, 1909, 24:354.

[2] Abstract of reports of the condition of Kansas banks, November 15, 1919.

its capital before it is eligible to membership, if there is a guaranteed bank in the same town already. The number of these young banks is quite large, and while they help to swell the total number of unguaranteed banks they have not had time to accumulate large deposit accounts.

However, attempts have been made to show that the guaranteed banks have drawn deposits. In November, 1909, Bank Commissioner Dolley gave out the following figures:[1] On June 30, 1909, the guaranteed banks had on deposit $52,000,000; by September 29, 1909, they had increased to $57,500,000, or a gain of 10.4 per cent. On the same dates the unguaranteed banks had on deposit $36,-450,000 and $39,500,000 respectively, or a gain of only 8.5 per cent. The figures for June, 1913, show that the deposits of the guaranteed banks were seven and one eighth times their capital, while the deposits of the unguaranteed banks were only five and one sixth times their capital.

The fact that between June 30 and September 29, 1909, the deposits of the guaranteed banks increased 10.4 per cent while those of the unguaranteed increased only 8.5 per cent, was undoubtedly due, in part at least, to the guaranty law. But this was the first three months of the law's operation, and it is natural that the impression on the public was pronounced. The fact that on any particular date the deposits of the guaranteed banks were seven and one eighth times their capital, while those of the unguaranteed were only five and one sixth, is wholly misleading. It has already been pointed out that as a rule the guaranteed banks are the larger banks. The small banks are the typical country banks and in these banks it is uncommon to see the deposits exceed four times the capital stock. On the other hand, the deposits of the city banks are usually from five to ten times their capital. Again, the young banks are automatically debarred from the system and the youth of these banks causes their ratio of deposits

[1] *Chicago Banker*, November 13, 1909, p. 20.

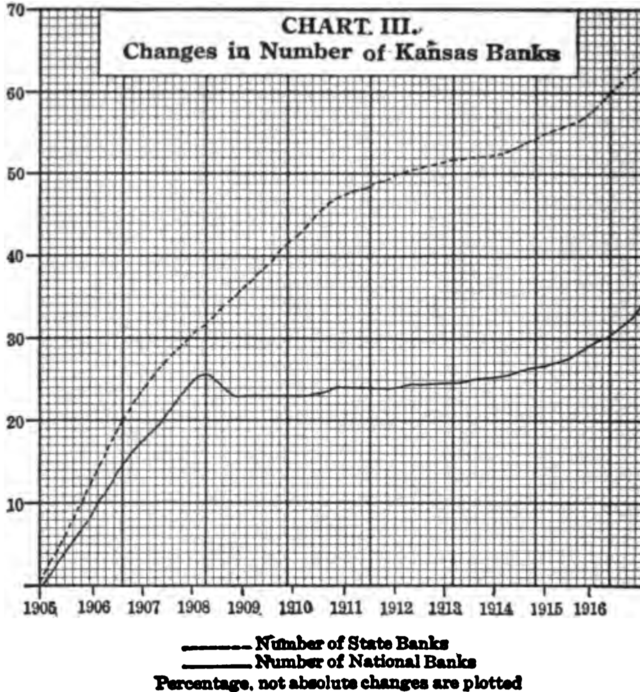
to capital to be abnormally low. This distribution of banks must be taken into consideration before figures as to the ratio of deposits to capital are interpreted to mean anything. There are a certain number of people who undoubtedly prefer the guaranteed banks, even in a time when failures are practically unknown, but the fact that little more than one half of the banks feel that this element is worth the slight cost that the law has occasioned up to the present time is probably the best indication of the effect of the law on the depositing public. But public feeling is a fickle thing, for while in the absence of bank failures the above-described condition might exist indefinitely, a series of spectacular failures, such as the state has just experienced, may greatly change the situation.

There is left to consider what effect the guaranty law has had on the national banks. The following table gives the number and the deposits of the state and the national banks. The figures for the four years prior to 1909 are given in order to show the normal course of events before the enactment of the law:

Year	*Number of state banks* *	*Number of nat'l banks* †	*Deposits of state banks* ‡	*Deposits of nat'l banks* §
1905.......	558	171	$51,555,000	$50,236,000
1906.......	628	188	62,343,000	58,268,000
1907.......	701	203	71,773,000	64,978,000
1908.......	747	211	76,716,000	63,059,000
1909.......	777	209	93,121,000	67,721,000
1910.......	843	208	102,667,000	67,846,000
1911.......	869	210	96,255,000	63,986,000
1912.......	896	211	102,128,000	67,753,000
1913.......	908	213	113,743,000	70,569,000
1914.......	927	213	107,960,000	69,402,000
1915.......	936	217	118,692,000	79,631,000
1916.......	987	221	165,620,000	96,429,000
1917.......	1016	230	211,133,000	126,081,000
1918.......	1054	236	249,788,000	137,759,000

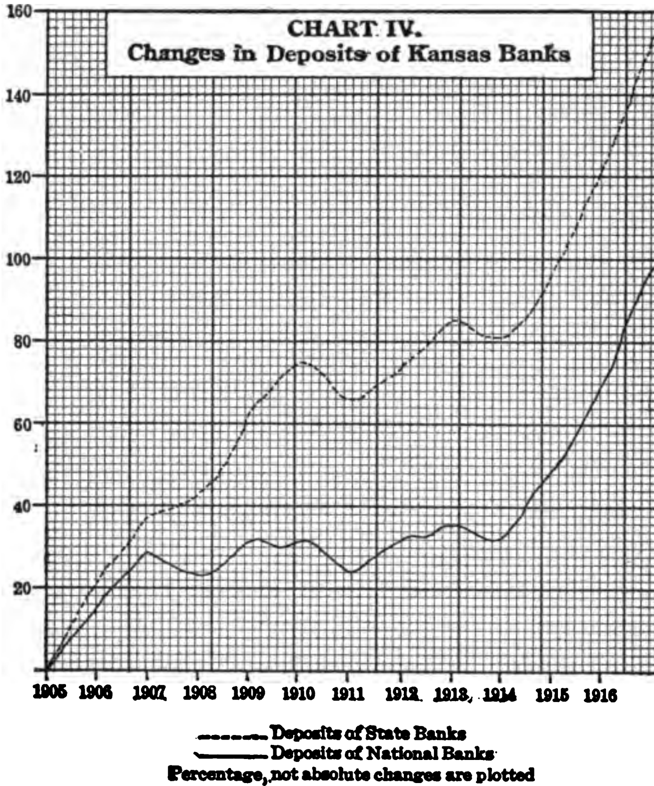
* *Twelfth Biennial Report of the Bank Commissioner*, p. 493, and special reports.
† *Report of the Comptroller of the Currency*, 1918, vol. II, p. 300.
‡ *Ibid.*, note 1. § *Ibid.*, note 2.

These figures show that from 1905 to 1909 the number of national banks increased 22 per cent, while their deposits increased 33 per cent; that in the same time the number of



state banks increased 39 per cent and their deposits 86 per cent. This indicates that the national banks were enjoying a healthy growth, although not developing as rapidly as the state banks. But the year 1909, the year in which the guaranty law was passed, marks a change. From 1908 to 1910 there were 96 new state banks chartered, and the deposits of the state banks in those two years jumped $25,-951,000. In the same time the number of national banks decreased by three, while their deposits increased only

$4,662,000. There is no doubt that this was largely due to the guaranty law. Bank guaranty was a new experience and the bankers for a time greatly overestimated its effect



on the depositing public. Consequently, those who were contemplating the organization of a bank, being uncertain as to the effect of the law, avoided the national system. Since this abnormal two-year period, the state banks have continued to develop rapidly, while the national banks, as regards numbers, have little more than held their own. But to explain this wholly there is another important factor

which must be considered. We refer to the movement which resulted in the establishment of small country banks in almost every little village. Small towns, which twelve or fifteen years ago no one thought of as having a bank, now support a prosperous little institution. These country banks have sopped up many of the rural deposits which before went to the large city depositories. This unexpected development of country banks is probably the principal reason for the slowing-down of the growth of national-bank deposits.

It is patent that up to the recent failures the test of bank guaranty in Kansas has been a fair-weather test. The state has long since recovered from the effects of its over-development thirty years ago and has reached a maturity and stability that make possible a reasonably fair test of a guaranty law. In addition to this the state has enjoyed its full share of the past two decades of general good times. Wealth has accumulated and values have been greatly enhanced, with the result that until recently bank losses have been almost unknown. We have seen that in the past year a veritable epidemic of bank embezzlements has passed over the state. Undoubtedly these embezzlements are connected with the rising prices that have marked the past few years, for speculation feeds on price fluctuations and the indications are that too many Kansas bankers have been speculating with other people's money. It is possible that public officials, both state and national, charged with the supervision of banks, have not been sufficiently alert to the temptation which besets bank officials to speculate with the funds at their disposal when prices are advancing rapidly.

On the other hand, bank failures have a great tendency to multiply in a period of depression. What would happen, therefore, should conditions like those of 1893 return? What would happen in the event of a worldwide depression aggravated by a persistent recurrence of lean harvests in

Kansas? Such a conjuncture a quarter of a century ago wrecked more banks in Kansas than have failed in Oklahoma, and such a thing on a smaller scale might happen again. Such a catastrophe might so burden the guaranteed banks as to cause them to quit the system as did the large state banks of Oklahoma. Kansas might then awaken to the fact that her voluntary system was no system at all. On the other hand, such an event might so affect the depositing public as to force practically all state banks under the operation of the law. All this is pure speculation, but it serves to show that the full test of the Kansas law lies yet in the future.

Since the assessments provided by the Kansas law are very light the guaranty fund did not grow rapidly. On September 13, 1916, this fund amounted to $191,080.72. At the same time the state treasurer held $489,963.58 in bonds and cash as security for the payment of future assessments. By October, 1918, the guaranty fund had reached approximately $500,000, and the bonds deposited to guarantee future assessments were considerably in excess of this amount. The Kansas law provides that when the guaranty fund reaches $500,000 the assessments shall cease until the fund becomes depleted. It is evident, therefore, that since 1918 the banks have been free from assessments. When the current losses are finally adjusted, however, the guaranty fund will be very seriously depleted, and the indications are that the banks may be compelled to rebuild it entirely.

The fact that this fund is small is of no particular consequence. Some bankers feel that it would be better to dispense with the fund altogether. In such a case, when a bank failed there would simply be an assessment on the other banks sufficient to meet the loss. This would have the advantage of giving the banks the use of their assessments until they were needed, but it would be a disadvantage in that the inevitably irregular assessments would

prove much more irritating to the banks. This fund is much smaller than those being accumulated in most of the other states, but since it is drawn upon only after all assets have been liquidated, including the double liability of stockholders, it will probably be sufficient to meet losses which may reasonably be expected to occur.

CHAPTER V

THE NEBRASKA SYSTEM

1. *Conditions antecedent to the guaranty law.* The roots of bank guaranty in Nebraska also reach back into Populist days. As in other granger states the boom fever of the eighties was followed in Nebraska by disaster and much suffering. It was the same sequence of events already observed in other states — a long series of crop failures, general falling prices, and the long depression of 1893. It was these events which crystallized that agricultural discontent known as the Populist movement. In the period from 1891 to 1896 Mr. Dickinson tells us: [1]

> The creditors of Nebraska banks had over five million dollars tied up in 101 failed banks, of which sum creditors of the nationals finally recovered less than a million, and creditors of state banks an unknown sum, perhaps something over a million. . . . The total number of banks in Nebraska fell from 650 in 1892 to 527 in 1896; and the aggregate deposits declined in the same time from $48,920,000 to $27,264,000.

The largest failure was that of the Capital National, in Lincoln, whose claims amounted to $1,300,000. Only about $250,000 was finally realized from its assets. The distress occasioned by this million-dollar loss to depositors was a tremendous object-lesson to the members of the legislature of 1893, which was then in session. Though no bill was introduced into the legislature for deposit guaranty until four years later, apparently it began to be talked of at that time as a practical scheme. C. W. Mosher, president of the Capital National, is credited with having written an article advocating a guaranty plan while in jail awaiting trial for criminal action in wrecking his bank.

It was also in 1893 that W. J. Bryan, then representative from

[1] Many of the facts given in this chapter regarding the historical background of the Nebraska system are drawn from an admirable pamphlet on bank-deposit guaranty in Nebraska by Z. Clark Dickinson, published by the University of Nebraska.

the First District of Nebraska, introduced a bill into the House [1] providing for the payment of depositors of insolvent national banks by an insurance fund administered by the Comptroller of the Currency. His action was inspired, some Nebraskans say,[2] by C. O. Whedon, who was for many years a consistent advocate of national-bank deposit insurance.[3]

According to Mr. Dickinson, thirty-six banks with over a million dollars of deposits failed in 1896.[4] This loss was probably the direct cause of the attempt the next year to enact a guaranty law. The bankers, however, were solidly against the measure and had little trouble in defeating it. Two years later another attempt was made to enact a guaranty law, but again it met defeat at the hands of a powerful banking lobby. Six years now elapsed before another bill was introduced into the legislature. The last attempt was made in 1907, but ten years had greatly changed economic conditions in the state and guaranty bills now attracted much less attention. These early bank failures made a powerful impression on the people of Nebraska and it required only the panic of 1907, the Oklahoma example, and the attitude of the Democratic Party in the election of 1908 to cause the bank-guaranty idea to spring into reality.

In the early fall of 1908 the state Democratic organization followed the example of the national platform and pledged itself to the enactment of such a law. Mr. Shallenberger, the Democratic gubernatorial nominee on this bank-guaranty platform, was the man who had been principally responsible for the defeat of the guaranty bill of 1899. An attempt was made on the part of some of the Republicans to put the Republican state organization on record in favor of the proposition also. As we have seen, this had been done in Kansas, but in Nebraska the bankers were exceptionally well represented in the councils of the

[1] H.R. 8378, *Congressional Record*, vol. 25.
[2] F. A. Harrison and W. L. Locke, of Lincoln.
[3] Dickinson, *Bank-Deposit Guaranty in Nebraska*, pp. 10–11.
[4] *Ibid.*.

Republican Party and the attempt to commit the party to bank guaranty was unsuccessful. The issue was, therefore, sharply drawn. The Democrats triumphed at the polls, but by the time the legislature met in 1909 the bank-guaranty idea had begun to grow cold, and the personal influence of Mr. Bryan was required before such a law could be passed.

2. *The law and its amendments.* The law finally enacted was passed March 25, 1909. This law is patterned after the Oklahoma law rather than that of Kansas. The law is compulsory for all state banks. It provides for the creation of a fund equal to one and one half per cent of deposits. When the fund reaches this amount the assessments cease; but when the fund becomes depleted below one per cent of deposits the assessments are resumed. The law provides that for the first two years there should be four semiannual assessments of one fourth of one per cent of average daily deposits, and after that semiannual assessments of one twentieth of one per cent of average daily deposits.[1] Should the fund fall below one per cent of average deposits the state banking board must levy a special assessment, but this assessment must not exceed one per cent of average daily deposits in any one year.[2] The banks themselves are allowed the custody of this fund. The state banking board notifies each bank of the amount of its assessment, and the bank then sets aside this amount and holds it payable to the board on demand.

New banks organized after the law took effect are required to pay four per cent of their capital to the fund when they open for business. This amount is subject to adjustment on the basis of average daily deposits as shown by the first two semiannual assessments. In any case the first two semiannual assessments plus the four per cent of capital originally contributed must equal at least one per

[1] *Digest of State Banking Statutes*, p. 374. [2] *Ibid.*, p. 375.

cent of average daily deposits as shown by the first two semiannual statements.[1]

In the event of the failure of a bank the depositors have priority over all other claims except those of taxes. When such a bank is placed in the hands of a receiver the depositors are paid out of the available cash. If this cash is insufficient to meet all claims the court that is handling the receivership certifies to the state banking board the amount of the deficiency, and the board then determines the share of each bank and draws sufficiently on it to make up the balance.[2]

A few minor amendments to the law have been made. The first act, following the example of the Kansas law, provided that investments of a bank could not exceed eight times its capital and surplus. This was felt to be too great a handicap on the banks and the law was relaxed, making the ratio ten instead of eight times capital and surplus. The original law had omitted any provision regulating the security which guaranteed banks were required to give for public deposits. In 1911 this was remedied by the provision that banks which had complied with the law should not be required to give any further security for public deposits.[3]

Several features of this law are worthy of special notice. In the first place, it makes no provision for the issuance of any kind of an interest-bearing certificate. The system attempts to pay depositors as soon as a receivership court can close the affairs of the failed institution, yet it is accumulating a very modest fund for this purpose. It is patent that in the event of a serious concentration of loss the system would break down. Oklahoma has shown the wisdom of having the bank commissioner close the affairs of a failed bank rather than by the method of the old receivership process. In such a case the commissioner often

[1] *Digest of State Banking Statutes*, p. 375. [2] *Ibid.*, p. 376.

[3] *Quarterly Journal of Economics*, 1913, 28:100.

finds it advisable to pay temporarily the large majority of the depositors from the guaranty fund in order that he may hold the assets of the failed bank for a more favorable market. Of course, as these assets are realized upon the guaranty fund is reimbursed. But this method necessitates a larger guaranty fund than when the assets are hurriedly rushed on to the market. In the event of heavy losses in Nebraska the fund might become so depleted that a wasteful sacrifice of assets would be necessary in order to pay depositors at once. The sale of certificates always insures a working guaranty fund, while it disseminates the shock of the failure by permitting the banks to retire these certificates at their leisure. Certainly such a scheme is preferable to one where the fund is maintained by onerous special assessments made at a time when a bank most of all needs to conserve its strength.

Almost from the start the Nebraska law was antagonized by the banks, both state and national. On April 23, 1909, a month after the passage of the law, the northern group of the Nebraska Bankers' Association passed a resolution voicing their disapproval of the law and sanctioning actions seeking to test the legality of the measure. A suit was soon filed by John L. Webster and ex-Senator W. V. Allen, representing fifty-two banks, to test the validity of the law. The contention was much the same as in Oklahoma. The Nebraska law had required all private banking concerns to incorporate and it was contended that this was unconstitutional in that it prohibited individuals from engaging in the banking business. It was also contended that the fundamental principle underlying the law was that it forced banks to contribute to a common fund to pay the losses of failed banks and that this was depriving them of property without due process of law. On June 30, 1909, a few days before the law was to go into effect, Circuit Judge Willis Van Devanter and District Judge Thomas C. Munger granted a temporary injunction restraining the

state banking board from putting the law into operation. Shortly afterward these same judges decreed that the law was unconstitutional and made the injunction perpetual. The judges recognized that the law prohibited private parties from engaging in the banking business, but refused to pass upon the merits of this point. However, on the main point the judges held that the law appropriated the assets of one bank to meet the obligations of another; that this was taking the property of one person without compensation to pay the debts of another, a thing which was expressly prohibited by the Fourteenth Amendment to the Federal Constitution. The case was appealed to the United States Supreme Court, and on January 2, 1911, that court advanced the Nebraska case and considered it with the Oklahoma and Kansas cases which were pending, and handed down a unanimous decision upholding the constitutionality of all three laws. Justice Holmes in his opinion, a section of which was quoted in connection with the discussion of the Oklahoma law in a preceding chapter, overruled the decree of Justices Van Devanter and Munger and dissolved the permanent injunction by which they had restrained the state banking board from putting the Nebraska law into operation. On January 3, 1911, the day after his opinion was overruled, Justice Van Devanter was sworn in as an Associate Justice of the United States Supreme Court.

The Nebraska law, which had been in the courts for nearly two years, was now free to go into operation. The Attorney-General of Nebraska ruled that the banks would not be required to pay the assessments while the law was in litigation and the state legislature soon after amended the law by omitting such assessments and provided that assessments should begin on July 1, 1911.

3. *Bank failures.* Since the Nebraska law went into operation three bank failures have occurred occasioning a loss

to the guaranty fund of approximately $348,000. When the assets of these banks are liquidated a considerable part of this amount will be returned to the fund. The First State Savings Bank of Superior and the Farmers' State Bank of Decatur, the first two banks to fail, have each paid a dividend of about fifty per cent.[1]

About the same time two national banks failed in Nebraska. The First National Bank of Sutton, with deposits of $185,918.31, and the First National Bank of Superior, with deposits of $235,495.73, were closed November 5, 1913, and January 12, 1914, respectively. It required nearly five years to close the affairs of the Sutton Bank and then a dividend of only 14.50 per cent was paid to depositors. The Superior Bank has paid a dividend of 31 per cent.[2]

The First National Bank of Superior and the First State Savings Bank of Superior failed in the same town within three months of each other. In fact, it was the failure of the national bank that pulled down the state bank. The depositors of the state bank were paid in full within three weeks,[3] while the depositors of the national bank after four years have received only thirty-one cents on the dollar and with the prospects of never receiving more than this amount.[4] The public was not slow in seeing the striking contrast, and every national bank in the county, taking the hint, renounced its national-bank charter and incorporated under the state law.[5]

4. *The effects of the law on the state and the national banks.* Before we begin a more detailed examination of the effects of the law upon the banks and the depositing public, it will be necessary to examine the relative growth of the

[1] Letter from the secretary of the state banking board.
[2] *Report of the Comptroller of the Currency*, 1918, vol. II, p. 105.
[3] *Quarterly Journal of Economics*, 1914, 29:193.
[4] *Report of the Comptroller of the Currency*, 1915, vol. II, p. 107.
[5] *Quarterly Journal of Economics*, 1914, 29:193.

state and the national banks in a period before the guaranty law was passed. The panic of 1907 upset the normal growth of the banks in the two years immediately preceding the enactment of the law, but if we take the three years from 1904 to 1907 we have a period in which conditions were normal and figures trustworthy. In the year 1904–05 the national banks of Nebraska gained 12 in number, or 8 per cent,[1] and the deposits increased $9,221,000, or 12 per cent;[2] the state banks gained 31 in number, or 6 per cent, and deposits increased $10,582,000, or nearly 27 per cent.[3] In the year 1905–06 the national banks gained 20 in number, or nearly 13 per cent, and deposits increased $8,187,000, or 14 per cent;[4] the state banks gained 38 in number, or 7 per cent and deposits increased $7,417,000, or 15 per cent.[5] In the year 1906–07 the national banks gained 17 in number, or nearly 10 per cent, and deposits increased $8,933,000, or about 11 per cent;[6] the state banks gained 37 in number, or 6 per cent, and $6,862,000 in deposits, or 12 per cent.[7] If we take an average for these three years, we find the following relative growth:

	Increase in number	*Increase in deposits*
National banks......	10 per cent	14.6 per cent
State banks.........	6.3	18

This shows that in the three normal years before the days of bank guaranty the tendency was for the number of national banks to increase faster proportionally than the state banks, but for the deposits of the state banks to grow faster than those of the national.

We have seen that at first the banks were bitterly opposed to a guaranty law. For fifteen years after the year

[1] *Report of the Comptroller of the Currency*, 1913, p. 362. [2] *Ibid.*.

[3] *Report of the Secretary of the State Banking Board*, 1912, p. xvi.

[4] *Report of the Comptroller of the Currency*, 1913, p. 362.

[5] *Report of the Secretary of the State Banking Board*, 1912, p. xvi.

[6] *Report of the Comptroller of the Currency*, 1913, p. 362.

[7] *Report of the Secretary of the State Banking Board*, 1912, p. xvi.

1897 bank failures were practically unknown in Nebraska. This remarkable record naturally caused the public to lose interest in a guaranty law, and this public indifference encouraged the banks in their opposition to the law. Consequently we find many of the larger state banks nationalizing. In 1908, the year the guaranty law was passed, 7 state banks went over to the national system;[1] in 1909 there were 5, with a total capital stock of $390,000;[2] in 1910 there were 8, with a total capital of $525,000;[3] and in 1911 11 joined the national system with a total capital of $420,000.[4] The fact that 24 state banks nationalized in the first three years after the passage of the law, and in a period in which there had been no bank failures to cause a loss, shows that many of the banks had little sympathy with the law and wanted to escape the rather heavy initial assessments.

But while the guaranty law at first put a damper on the growth of the state banks it did not stop the growth. On November 16, 1909, there were 662 state banks, with deposits amounting to $71,139,000;[5] on November 26, 1912, there were 694, with deposits amounting to $80,631,000.[6] Thus in this period the number of state banks increased a little over 13 per cent. Comparing these figures with those for the rate of increase of the state banks from 1904 to 1907, we see that from 1909 to 1912 the rate of increase in number fell about one and one half per cent, while the rate of decrease in deposits was about five per cent.

In 1909 there were 219 national banks in Nebraska, with deposits amounting to $83,369,000. By 1912 the number had increased to 245, with $96,907,000 in deposits,[7] an increase of 12 per cent in number and 16 per cent in deposits. The figures for the growth of the national banks

[1] *Report of the Secretary of the State Banking Board*, 1908, p. xix.
[2] *Ibid.*, 1909, p. 19. [3] *Ibid.*, 1910, p. 7.
[4] *Ibid.*, 1911, p. xviii. [5] *Ibid.*, 1909, p. ii.
[6] *Ibid.*, 1912, p. viii.
[7] *Report of the Comptroller of the Currency*, 1913, p. 362.

during the period from 1904 to 1907 were 10 per cent gain in number and 14.6 per cent in deposits.

This shows that the growth of the national banks from 1909 to 1912 was more than normal, and that they gained what the state banks lost. If we compare the figures for both kinds of banks in this three-year period, we see that the state banks increased five per cent in number and thirteen per cent in deposits, while the national banks increased twelve per cent in number and sixteen per cent in deposits, which figures show a decided contrast to those for the period from 1904 to 1907. These figures are especially interesting when it is borne in mind that for two of these three years the law was not in actual operation because of court injunctions.

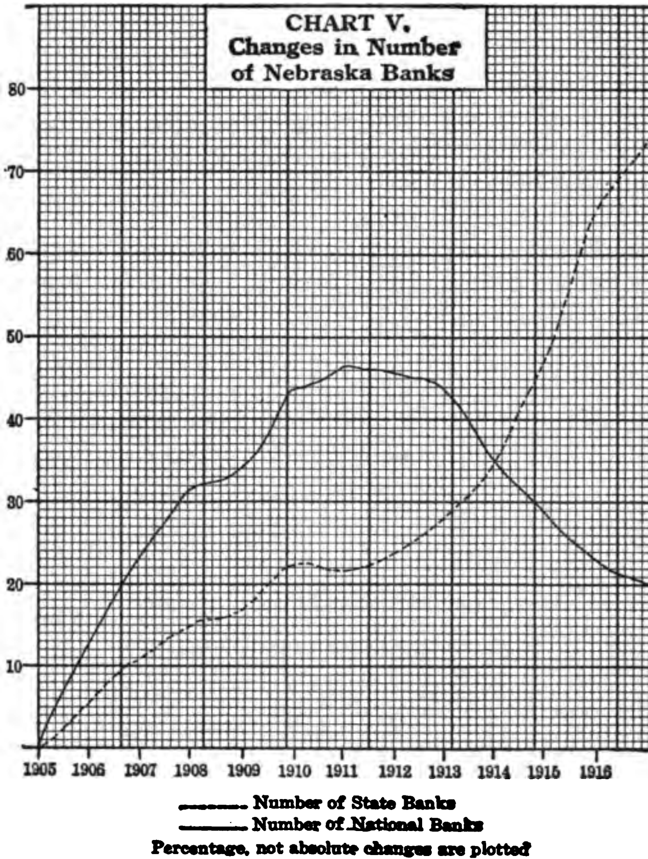
The year 1912 marks a turning-point in this movement toward bank nationalization. The fact that no state banks nationalized in this year shows that the antagonism of the banks to the guaranty law is dying out. At first the banks opposed the law because they believed it wrong in principle and certain to prove dangerous in practice. But five years passed without a failure and the ones that have occurred since have not been of any great consequence. Under the Nebraska law the banks have the custody of the guaranty fund. Consequently in this period they have not been irritated by having to make excessive payments and at the same time they have had the use of their share of the fund. All of these factors working together have tended to modify the antagonism of the banks.

If now we take the period from 1911 to 1919, the eight years in which the law has been in actual operation, we find convincing proof of this reaction. On August 31, 1911, there were 662 state banks, with deposits amounting to $75,590,000; [1] on May 20, 1918, there were 910 state banks, with deposits amounting to $231,506,000; [2] an in-

[1] *Report of the Secretary of the State Banking Board*, 1911, p. ix.

[2] *Report of the Comptroller of the Currency*, 1918, vol. II, pp. 785–89.

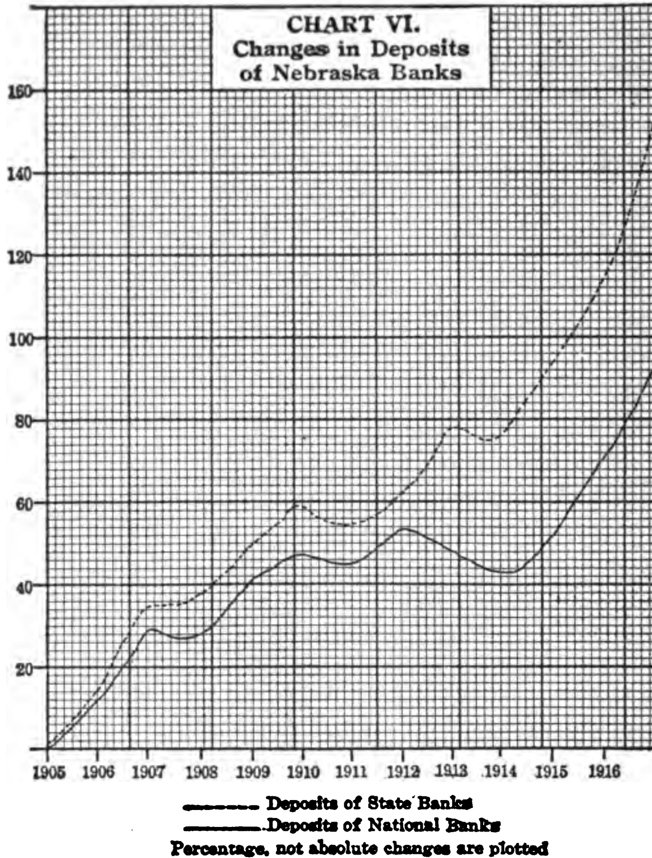
crease of over 37 per cent in number and over 306 per cent in deposits. In 1911 there were 246 national banks, with deposits of $90,473,000;[1] by 1918 the number had de-



creased to 191, with deposits amounting to $148,275,000;[2] an actual decrease of over 22 per cent in number and an increase of nearly 64 per cent in deposits.

[1] *Report of the Comptroller of the Currency*, 1918, vol. II, p. 309.
[2] *Ibid.*.

This remarkable shifting of banks and deposits from the national to the state system indicates clearly that the banks have become reconciled to the guaranty law and are



even beginning to enter into it enthusiastically. It has already been pointed out that after the failure of two banks in Superior, Nebraska, — one a state and the other a national bank, — every national bank in the county

changed over to the state system. It has been suggested [1] that the dissatisfaction of the national banks with the Federal Reserve Act has been a potent factor in the large number of conversions to state banks. This may have played a part, but the fact remains that the specter of the guaranty law did not deter the banks in making the change. The figures seem to show also that the law is popular with the public and is now drawing deposits. On December 9, 1915, the total deposits of the state banks were $110,875,684.20, of which amount $47,934,460.27 represented time certificates of deposit.[2] The time deposits in the national banks of Nebraska at the same time were only $20,667,657.92, or much less than half those of the state banks.[3] The guaranty law seems to be the only explanation of this striking contrast — an explanation generally admitted as correct by the national bankers of the state. The secretary of the state banking board is becoming alarmed at the proportions assumed by these certificates of deposit on the books of the state banks. He thinks that a considerable portion of these funds comes from banks and bankers outside of the state, and that in the event of a crisis these banks would be compelled to lift their deposits very suddenly, thus seriously embarrassing the Nebraska banks.

However, it is evident that the Nebraska law has as yet been given no real test. So far the law has cost the banks very little, and since it brings them business it is natural that they should be favorably inclined to it. But that test will come or the history of the past teaches nothing. Moderate losses would probably be made good cheerfully, but should losses necessitate such heavy special assessments as to consume annual dividends for a series of years the attitude of the banks might greatly change as the Oklahoma incident well shows.

[1] *Quarterly Journal of Economics*, 1914, 29:194.
[2] *Report of the Secretary of the State Banking Board*, 1915, p. ix.
[3] *Report of the Comptroller of the Currency*, 1915, vol. II, p. 196.

On December 5, 1911, after six months of the operation of the law, the depositors' guaranty fund amounted to $176,645.64.[1] One year later it was $573,375.34,[2] while on March 1, 1920, it was approximately $2,500,000.[3] This fund should meet any ordinary loss, but should a serious breakdown occur a hurried amendment to the law might be necessary, for the plan attempts to pay depositors at once, yet makes no provision for the issuance of certificates of indebtedness by which either temporarily to satisfy depositors or to borrow money with which to pay them. The Oklahoma experience shows that the banks cannot reasonably raise a fund sufficient in itself to meet all immediate losses. As the law is now constituted its success will depend, therefore, largely on the ability of the state banking board to prevent a concentration of loss. If failures are so distributed as to allow the fund to recoup itself in the meantime, all will be well.

[1] *Report of the Secretary of the State Banking Board*, 1911, p. xiii.
[2] *Ibid.*, 1912, p. xiii.
[3] Letter from the secretary of the state banking board.

CHAPTER VI

THE TEXAS SYSTEM

1. *Conditions antecedent to the guaranty law.* Certain unique features of Texas banking history must be stated in order to understand fully the development of bank guaranty in that state. A distrust of financial institutions has marked American history from the time of the first United States Bank to the recent excitement over the so-called "money trust." Texas, sharing this common distrust, carried her crusade against banks to an extreme. On February 5, 1844, an act passed by the Congress of the Republic of Texas was approved, providing "that all laws, granting to any individual, individuals or corporations, the authority to issue either bills or promissory notes, to pass and circulate as money, is hereby repealed, and the authority to issue either bills or promissory notes, or any other instrument in writing, in print, hieroglyphics or engraving, to circulate as money, is hereby abridged." [1] Article VII, Section 30, of the constitution of 1845, provided that "no corporate body shall hereafter be created, renewed, or extended with banking or discounting privileges." [2]

These prohibitions of banking institutions show how Jacksonian Democracy had gripped that state. The sentiment of that day was well expressed by Mr. Rush, the president of the convention that framed the constitution of 1845. He said:

I think, as a member of the convention and the community, that it is due to myself, the country, and the people themselves, to restrain them from doing anything which would result in their injury. The gentleman from San Patricio says that many indi-

[1] *Laws of Texas*, vol. II, p. 1031.
[2] *House Documents*, vol. 91, part II, p. 3562.

viduals have been benefited by banks. Thousands upon thousands, sir, have been ruined by them. I consider it a bright page in the history of General Jackson, that he had the honor of giving the blow which will eventually destroy them upon this continent. And I wish by no vote of mine, here or elsewhere, to authorize the institution of a bank, which may benefit a few individuals, but will carry, here as elsewhere, ruin, want, misery, and degradation in its train.[1]

This sentiment held the people of Texas in such a spell that it was only in 1904 that their constitution was amended so as to permit state banks. In 1869 Texas, acting under the authority of the reconstruction acts, adopted a new constitution. This constitution omitted the section of the constitution of 1845 prohibiting banking institutions — there was no direct sanction, the prohibition being simply omitted. When the state was again admitted to the Union and the Democrats had returned to power the constitution of 1876 was promptly adopted. This constitution reinstated the banking prohibition of the constitution of 1845. Between 1869 and 1876, the constitution being silent on the subject, the legislature by special acts had granted charters to some eighteen banking institutions.[2] Thus prior to 1904 the national banks constituted the banking system of Texas.

It has already been noted in connection with the Kansas and Nebraska laws that widespread bank failures in the early nineties were the cause of the early bank-guaranty agitation in those states. Texas had prohibited state banks, and consequently there was not a lot of small, weak, and ill-regulated state banks to fail when the crisis of 1893 swept over the state. However, Texas did not escape the curse of bank failures, for between 1887 and 1909 thirty-two national banks failed in that state with losses to depositors of over $1,175,000.[3] We know also that bank guar-

[1] *Journals and Debates, Texas Constitution*, 1845, p. 461.

[2] Records in office of secretary of state, Austin, Texas.

[3] *Report of Comptroller of Currency*, 1915, vol. II, p. 129.

anty was being discussed in Texas in this period, for at the fifth annual meeting of the Texas Bankers' Association held at Dallas, May 8, 1889, M. E. Longcape read a paper in which he outlined a scheme for guaranteeing deposits.[1] But, since the state had no jurisdiction over the national banks, there was no occasion for any attempt at guaranty legislation.

In August of 1908 the Texas state Democratic organization, in harmony with the national Democratic platform, pledged the party to bank-guaranty legislation. In his message to the legislature of 1909 Governor Campbell called its attention to the pledge in both the state and national platforms. When the legislature met, however, it was found that the politicians of Texas, like those of other states, had played politics with the guaranty idea. There now ensued four long months of wrangling on the subject. Powerful opposition had in the meantime developed on the part of the national banks. These banks argued that Texas in prohibiting state banks before 1904 had compelled all banks to become national banks. These banks now contended that the state had no moral right, after forcing them into a position, to turn around and pass a guaranty law which would give the new state banks an unfair advantage. This opposition was so strong that the regular 1909 session of the legislature adjourned without passing a guaranty law.

The day following this adjournment the governor reconvened the legislature for the purpose of considering guaranty legislation. On April 5, 1909, Mr. Bryan addressed the legislature and spoke concerning the sanctity of platform pledges and closed with a strong plea for bank guaranty.[2] A serious attempt was now made to pass such a law, but the legislature soon became hopelessly divided. One wing wanted a pure and simple guaranty law, while the other

[1] *The Dallas News*, March 14, 1909.
[2] *Ibid.*, April 6, 1909.

wanted a plan by which each bank would furnish security of some kind to protect its own deposits. Neither side was disposed to yield and the legislature finding itself hopelessly deadlocked again adjourned.

The governor now promptly called a second extra session and at the same time severely reprimanded the legislature for its failure to fulfill platform pledges. He characterized some of their substitute bills as "a sham and a fraud," and added that "the most infamous lobby that ever trampled upon the will of the people has swarmed about the capitol from the beginning of your regular session until this hour."[1] The same conflict developed in this second extra session, but after another month of wrangling a compromise was effected. A law was finally passed in which the two rival schemes were agglutinated, leaving with each bank the option of which method it would use.

2. *The Texas law.* Texas has, therefore, created a dual system. Interest-bearing deposits and deposits otherwise secured are not protected by the law. But all other deposits must be protected by one of two methods, the plan to be used in each case being left to the choice of the bank. These two methods are known as the "Depositors' Guaranty Fund" and the "Depositors' Bond Security System." They are entirely distinct, but all corporations with banking and discount privileges and all banks and trust companies must protect their deposits subject to check in one of the two ways.

All banks and trust companies that elect to use the "Depositors' Guaranty Fund" are required to pay to the state banking board one per cent of their average checking deposits for the preceding year. Annually after this first payment the assessment is one fourth of one per cent of average checking deposits as shown for the preceding year. This assessment continues yearly until the fund reaches

[1] *The Dallas News*, April 12, 1909.

$2,000,000 when payments cease until the fund becomes depleted. When the fund becomes depleted, or when an emergency arises, the state banking board may require emergency assessments, but such assessments can never amount to more than two per cent of average checking deposits in any one year. Twenty-five per cent of each assessment is paid to the state banking board and the board in turn deposits it with the state treasurer. The remaining seventy-five per cent is credited on the books of the bank making the payment to the state banking board.[1] No provision is made for the issuance of interest-bearing certificates.

All new banks or trust companies that are admitted are required to pay three per cent of their capital and surplus into the fund, but this amount is subject to adjustment at the end of the year on the basis of their average deposits. Only banks and trust companies that are solvent and properly managed are admitted to the benefits of the fund, and the state banking board is the sole judge of these requirements.[2] National banks may also participate in the law, but the opinions of the Attorney-General in the Oklahoma and Kansas cases have made this provision inoperative.

In the event of the failure of a bank that has adopted this plan the depositors are paid at once out of the cash that can be made available. If this cash is not sufficient the guaranty fund is drawn upon for the remainder. When a bank is being liquidated the state has a first lien upon the assets for the benefit of the guaranty fund.[3]

Banks that elect to protect their depositors by means of the "Depositors' Bond Security System" are required to file with the bank commissioner, on the first day of each year, "on behalf of the depositors of the bank, a bond, policy of insurance, or other guaranty of indemnity in an amount equal to the amount of its capital stock, which

[1] *Digest of State Banking Statutes*, pp. 644–45.
[2] *Ibid.*, p. 645. [3] *Ibid.*.

bond or policy inures to the benefit of the depositors."[1] The bank commissioner is the sole judge of the worth of the security offered and may accept or reject it as he sees fit.

When a bank whose deposits are so secured fails, the bank commissioner takes charge and proceeds to liquidate. He notifies the persons obligated in the bond, policy, or guaranty of indemnity, and sixty days after this notice these instruments become payable.[2] If a Texas corporation is obligated in the bond and refuses payment, its charter is forfeited; if a foreign corporation is obligated and refuses payment, it is prohibited from transacting business in Texas. If after ninety days payment is still refused, the attorney-general is required to bring suit.[3] Whenever the deposits of a bank exceed six times its capital and surplus, additional security must be filed, which security must be equal to the amount of the excess.[4]

Every state bank and trust company must hold a certificate from the bank commissioner stating which method of protecting deposits it has elected. Failure to hold such a certificate is punishable by forfeiture of the charter.[5] Banks are allowed to advertise that they are "Guaranty Fund Banks" or "Guaranty Bond Banks" as the case may be, but a bank that advertises that its deposits are secured by any other method than the two provided by law, or that its deposits are guaranteed by the State of Texas, is guilty of a misdemeanor punishable by fine or imprisonment or both.[6]

The law of 1909 also made more stringent the regulation of banks. It provides that no state bank or trust company can own more than ten per cent of the capital stock of any other banking corporation, unless such holding was for the purpose of securing itself against loss.[7] It provides additional penalties for bank defalcation. It limits the amount

[1] *Digest of State Banking Statutes*, p. 646.
[2] *Ibid.*, p. 647. [3] *Ibid.*. [4] *Ibid.*.
[5] *Ibid.*. [6] *Ibid.*, p. 641. [7] *Ibid.*, p. 639.

of indebtedness to the bank of any director or officer of the bank.[1] One of the most significant changes was in respect to the relation of deposits to capital. Texas is credited with making the first attempt in American history to establish an arithmetical relationship between the deposits and the capital of a bank. With a capital of $10,000, the deposits of a bank are restricted to five times its capital and surplus; with a capital from $10,000 to $20,000, to six times its capital and surplus; from $20,000 to $40,000, to seven times; from $40,000 to $75,000, to eight times; from $75,000 to $100,000, nine times; and if capital is over $100,000, to ten times its capital and surplus. If these amounts are exceeded, then within sixty days the bank must increase its capital twenty-five per cent.[2] By these additional regulations the law attempts to counteract any tendencies toward reckless banking that the guaranty system may engender.

From the very beginning the "Depositors' Guaranty Fund System" has been more popular with the banks. By August 31, 1910, 541 banks had selected this plan as against 43 that had selected the "Depositors' Bond Security System." [3] On December 1, 1915, there were 780 banks under the former plan, while only 56 were under the bond security system.[4] By December 31, 1919, the numbers were 942 and 41 respectively, showing that the guaranty plan continues to gain at the expense of the bond security system.[5]

The Texas law has never been taken into the courts. It went into operation January 1, 1910, and by August 31, 1910, the depositors' guaranty fund amounted to $431,-834.18.[6] On March 1, 1920, it amounted to $1,852,259.22, and the commissioner announces that the next assessment

[1] *Digest of State Banking Statutes*, p. 642. [2] *Ibid.*, p. 630.

[3] *Report of the Bank Commissioner*, 1910, p. 5.

[4] *Senate Document*, no. 478, 64th Congress, 1st Session, p. 3.

[5] Letter from the bank commissioner, March 5, 1920.

[6] *Report of the Bank Commissioner*, 1910, p. 5.

will cause the fund to reach the legal limit.[1] Since the law became effective, upwards of $750,000 has been used to pay depositors of failed banks. But these failed banks have paid substantial dividends and the approximate loss to date has been about $300,000.[2]

3. *Bank failures*. Since the law went into operation there have been fourteen state bank failures in Texas. A few of the more important of these failures will be described in order to show conditions in this state. In a number of them the loss was small, while in three of them the guaranty fund was reimbursed in full.

The first bank to fail was the Harris County Bank and Trust Company of Houston, which was closed on August 7, 1911. This bank had non-interest-bearing deposits amounting to about $190,000. Dishonest banking was the main cause of this failure. The bank commissioner reported that much of the paper of the bank was fraudulent; that many forged checks had been drawn on depositors' accounts and fake entries made in the books.[3] Frank W. Vaughan, the president, got away before he could be apprehended, and a reward of $500 was offered for his arrest and conviction.[4] To make good this failure $111,615.52 was drawn from the guaranty fund. Since the closing of the bank $72,550.16 has been collected from assets, leaving a net loss to the fund of $39,065.36.[5]

The second failure was that of the First State Bank of Kopperl, which occurred on December 5, 1911. This was a small failure, the bank having non-interest-bearing deposits amounting to nearly $16,000. S. J. Spotts, who with associates had purchased the bank, had previously served a term in the federal penitentiary at Leavenworth, Kansas, for wrecking a national bank near Paris, Texas. After the

[1] Letter from the bank commissioner, March 5, 1920. [2] *Ibid.*.

[3] *Report of the Bank Commissioner*, 1911–12, p. 19.

[4] *Ibid.*, p. 20.

[5] Letter of bank commissioner to state banks, August 31, 1918.

failure he was located in Los Angeles, California, brought back to Texas for trial, pleaded guilty, and was sentenced to four years in the state penitentiary.[1] Eight thousand dollars was drawn from the guaranty fund to pay depositors, but since the failure $4000 has been collected on assets.[2]

The Paige State Bank, of Paige, Texas, was closed February 10, 1912. The deposits of this bank amounted to over $25,000. This failure was directly caused by the president of the bank placing $19,000 of worthless paper in the bank on February 3, 1912, which was discovered by a special examination on February 7.[3] The bank commissioner in commenting on this failure said: "One of the regretful conditions that exist in our state bank system is the prevailing idea that any one can run a bank even without previous experience, and also that anybody can get a permit to start a bank without reference to financial responsibility, character, or qualifications."[4] It required $13,697.20 of the guaranty fund to pay depositors. Collections on assets have returned about ten per cent of this amount to the fund, but the bank commissioner thinks little more will be collected.[5]

The First State Bank of Amarillo was closed on April 2, 1914. This failure was caused by the bank making too many long-time loans which deteriorated in value because of adverse crop conditions. The guaranty fund was drawn on to the amount of $87,476.62. Of this amount $74,355.11 has been collected from assets and returned to the fund and the bank commissioner thinks that ultimately it will be fully reimbursed.[6]

The failure of the Farmers' and Merchants' State Bank

[1] *Report of the Bank Commissioner*, 1911–12, p. 21.
[2] *Senate Document*, no. 478, 64th Congress, 1st Session, p. 5.
[3] *Report of the Bank Commissioner*, 1911–12, pp. 21–22.
[4] *Ibid.*, p. 23.
[5] *Senate Document*, no. 478, 64th Congress, 1st Session, p. 5.
[6] *Ibid.*, p. 6.

of Waco required $61,539.39 from the guaranty fund to pay depositors, but the bank commissioner expects this bank to pay one hundred per cent dividends. To pay the depositors of the Farmers' and Merchants' State Bank of Teague $92,363.36 was taken from the guaranty fund. The Department of Insurance and Banking is not liquidating this bank, as the attorney-general filed receivership proceedings in the District Court of Travis County and the court appointed a receiver.[1] Already $15,387.68 has been recovered from assets, but the balance, $76,975.68, will probably be a total loss.[2]

The failure of the West Texas Bank and Trust Company of San Antonio, on April 3, 1916, represents the largest loss that the guaranty fund has sustained. This bank attempted to finance a number of real-estate transactions, and as some of them did not prove profitable heavy losses were sustained. The bank was reorganized with the assistance of some of the more influential stockholders and finally took over the entire assets of the defunct bank. The state banking board paid the new management $200,000 from the guaranty fund to protect it from loss in the liquidation of the assets of the failed bank. According to the commissioner no part of this sum will ever be returned.[3]

These Texas failures are fairly representative of bank failures in general. In the majority of cases their direct cause was due to human depravity and incompetence which even the more stringent banking laws of 1909 failed to eliminate. But a moment's consideration will show that conditions in Texas might have been much worse. Before 1904 the banking system of Texas consisted of national banks. National banks are of necessity banks of large capital and resources. This fact limits their field of opera-

[1] Letter of bank commissioner to state banks, August 31, 1918.
[2] *Report of the Bank Commissioner*, 1918, p. 21.
[3] Letter of bank commissioner to state banks, August 31, 1918.

tion to communities that can support such a bank. State banks are much less pretentious institutions, and are able to enter nearly every country village. When the constitutional amendment of 1904 lifted the prohibition on state banks, there was a great rush to fill this vacuum. In ten years 836 state banks were chartered. When we consider that few of these prospective bankers had any real banking experience, and, further, when we consider the task confronting the state banking board of issuing so many charters and looking up records of would-be bankers, it must be admitted that, on the whole, the work has been well done. Experience has shown that some dishonest and incompetent men were permitted to engage in the banking business, but when the mushroom growth of the state banking system is considered it seems remarkable that more of the same kind did not slip in.

The conditions in Texas have been much less favorable for an ideal guaranty experiment than those of Kansas and Nebraska. In the two latter states the state banks had been long established and economic conditions were most favorable. Texas, on the other hand, rather rashly grafted a guaranty system on to a lot of newly established banks. This was a dangerous procedure as the Oklahoma experience well shows. From 1912 to 1915 crop conditions were poor and the cotton market unfavorable. These forces working together have caused more trouble with bank failures than might reasonably be expected. But while in the aggregate the loss seems rather large, the burden, when scattered over the banks of that vast and opulent state, has been of no great consequence. The bank commissioner estimated in 1916 that up to that time "each share of stock of the par value of $100 has paid only 3½ cents per annum, or 21 cents in six years, for this insurance." [1] However, recent losses will make the average expense somewhat more than the above figures.

[1] *Senate Document*, no. 478, 64th Congress, p. 3.

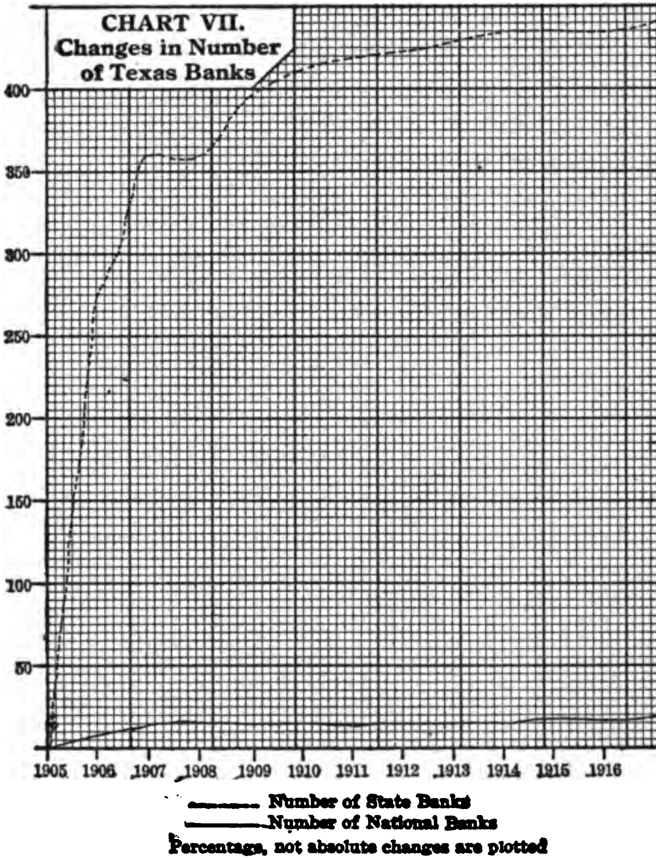
4. *The effects of the law on the state and the national banks.* Attention is now directed to the relative growth of the state and the national banks in Texas. The following table shows this growth:

Year	*Number of state banks* *	*Number of nat'l banks* †	*Deposits of state banks* ‡	*Deposits of nat'l banks* §
1905........	29	440	$1,731,000	$101,285,000
1906........	136	483	11,129,000	116,331,000
1907........	309	521	18,562,000	141,803,000
1908........	340	535	24,015,000	115,843,000
1909........	502	523	43,329,000	139,024,000
1910........	621	519	54,605,000	145,249,000
1911........	688	513	59,333,000	156,083,000
1912........	728	515	64,556,000	179,736,000
1913........	776	517	86,485,000	183,623,000
1914........	849	519	76,101,000	174,033,000
1915........	831	535	104,975,000	185,100,000
1916........	836	532	160,417,000	255,348,000
1917........	874	540	215,906,000	310,374,000
1918........	874	543	203,642,000	333,717,000
1919........	970		336,018,000	

* *Report of the Bank Commissioner*, 1918, pp. 29–85.
† *Report of the Comptroller of the Currency*, 1918, vol. II, p. 320.
‡ *Senate Document*, no. 473, and *Reports of Bank Commissioner.*
§ *Report of the Comptroller of the Currency*, 1918, vol. II, p. 320.

The figures for the period covered by this table show that the field of operation of the national banks was well-nigh occupied, while that of the state banks was just being developed. The mushroom growth of the state banks was probably not affected to any great extent by the guaranty law, but was rather the result of the rush to fill the vacuum that existed before 1904. From 1908 to 1911 there was a steady decline in the number of national banks. This retrograde movement may have been caused by the guaranty law, or it may have been due to the pressure of the rapidly growing state banks. But while the number of national banks declined for a few years, their deposits increased rapidly. This growth of the national-bank deposits is the more remarkable when it is considered that new state

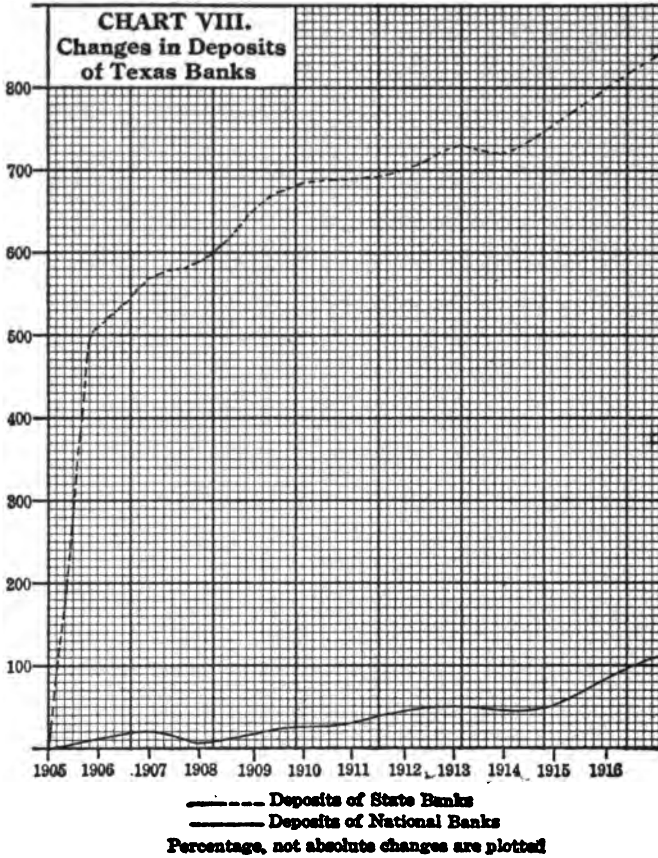
banks were springing up on every side of the national banks and would naturally absorb many of their deposits. The national banks were the old established banks of the



state; they had their friends, and this was a great help in their competition with the new state banks operating under the prestige of the guaranty law.

On March 1, 1920, the guaranty fund amounted to

$1,852,259.22. At that date the assessment for the year 1919 had not yet been made, but when this assessment is added to the fund the legal limit of $2,000,000 will be ex-



ceeded. This is one of the largest funds being accumulated in any state, but the number of banks which it must protect is rapidly approaching the one thousand mark. The Texas law is being ably administered, and, if economic

conditions in the state remain normal, its operation will undoubtedly continue uneventful. However, the Texas law harbors two elements of weakness. It attempts to pay depositors at once and at the same time makes no provision for the issuance of interest-bearing certificates with which to borrow money on the credit of the guaranty fund should a great emergency arise. The Oklahoma experience has furnished the proof that, should the unexpected happen, such a plan could not cope with the situation.

CHAPTER VII

DEPOSIT GUARANTY IN OTHER STATES

1. *Unsuccessful bank-guaranty agitation.* The bank-guaranty propaganda of 1908 extended much farther than the four states that have been considered. The other principal states that gave the subject serious consideration were Arkansas, Florida, Mississippi, Georgia, Tennessee, Iowa, Wisconsin, Missouri, Colorado, Nevada, Montana, North Dakota, and South Dakota. In most of these states bills providing for the guaranty of bank deposits were presented and defeated. In some cases the agitation was extremely feeble; in others the proposal died only after a determined and bitter contest; while in four states — North and South Dakota, Mississippi, Washington — the movement resurged resulting in guaranty laws five or six years later.

The Colorado Democrats, being greatly influenced by the Denver Convention, adopted a deposit-guaranty plank in 1908. They were successful at the November election, and when the legislature met in January, 1909, much attention was given to such legislation. Two guaranty bills were submitted at this session. One bill provided for a mutual plan. A fund to protect deposits was to be accumulated by means of assessments levied upon the banks. The second bill made the protection of deposits an individual matter with each bank. This bill provided that each bank should set aside an amount equal to one per cent of its deposits. This fund was to be invested in bonds or warrants approved by the bank commissioner and deposited with the state treasurer. These securities were to be held as a protection for deposits in case of insolvency. But the friends of bank guaranty were unable to unite on any one plan and the legislature adjourned without passing either bill.

The matter rested here until 1911 when such legislation was again urged. A bill which embodied both plans, considered two years before, was proposed and favorably acted upon by the legislature. In this respect it was like the Texas law. Each bank was given an option between two methods of securing deposits. One was by the mutual plan proposed in 1909, which provided for the creation of a fund equal to $1,000,000. This fund was to be accumulated by an assessment the first year of one per cent of average deposits and annually thereafter by an assessment of one fourth of one per cent until the fund was accumulated. The other method was patterned after the individual plan of 1909. Each bank was required to deposit collateral security equal to its capital and surplus or file a bond which was acceptable to the bank commissioner to the same amount. This bill passed the legislature with a referendum provision attached requiring that it be submitted to the people for approval before it should become a law. The bill was never submitted, for before the next general election the District Court at Denver declared that the bill had been passed illegally. This attempt marked the end of the agitation in Colorado.

The State of Wisconsin has given much attention to guaranty legislation. In 1910 the legislature sent a special committee to Oklahoma to study the situation. The Oklahoma system had just been staggered by a three-million-dollar failure and the committee returned advising against such a law on the ground that it engendered bad banking. However, the sentiment for such legislation was so strong that a guaranty bill was introduced and it only failed of enactment by a tie vote in the Senate.

There was violent opposition to the idea on the part of the bankers, and when the guaranty bill was defeated they took steps to forestall such legislation in the future. The plan was to form a mutual insurance company under the direction of the Wisconsin Bankers' Association to insure

the deposits of banks. The legislature of 1911 passed a law permitting the formation of such a company, and the Wisconsin Bankers' Association appointed a committee to work out a plan of organization. A plan was drawn up providing for a company, membership in which was to be optional on the part of the banks. The plan was presented to the 1912 session of the Wisconsin Bankers' Association where it precipitated a lively discussion and was referred back to the committee for further consideration. Since then the subject has attracted little attention.

2. *The South Dakota system.* South Dakota stands in a peculiar position in regard to the guaranty movement. In that state both the Democrats and the Republicans in 1908 took their stand in favor of such a law. The Republicans carried the state and, much to their discomfort, the responsibility for such legislation devolved upon them. Their preëlection warmth for the idea was prompted by fear rather than love. In the meantime an intense opposition to such legislation had developed on the part of the banks. Consequently when the legislature assembled in 1909, the majority party found itself in a predicament. However, to meet campaign pledges a most ingenious plan was hit upon. A voluntary law similar to that of Kansas was enacted, but with the requirement that at least one hundred banks must signify their intention of participating in the law before it could become operative. A heavy membership fee was also required, and this, in conjunction with the hostility of the banks, was sufficient to keep the law from getting into operation.

In the absence of bank failures this adroit political move might have proved satisfactory to the people of South Dakota. But in the next three years fourteen failures occurred with losses estimated from thirty to thirty-five per cent.[1] In the meantime the working of the laws in the other

[1] Letter from the public examiner, South Dakota.

states was being closely watched, and South Dakota was undoubtedly influenced most of all by the successful operation of the law in her neighbor-state, Nebraska. South Dakota became convinced that such legislation was sound, and, stimulated to action by the failure of banks, the legislature in March, 1915, enacted a new guaranty law.

The guaranty system of South Dakota is administered by the "Depositors' Guaranty Fund Commission." This commission is composed of the public examiner and three other persons. These three other persons, however, are not political appointees, for the governor must appoint them from a list of twelve persons submitted to him by the State Bankers' Association. South Dakota undoubtedly got this idea from Oklahoma, where, as already pointed out, the state bankers in a similar manner separated the control of the state banking board from the influence of politics.

In most other respects South Dakota has patterned her guaranty system after that of Nebraska. South Dakota made this law compulsory. All deposits not otherwise secured are protected. The annual assessment is one fourth of one per cent of average daily deposits. When this point is reached the assessments cease until the fund falls below one per cent. When the assessments become due, each bank sets aside on its books that amount to the credit of the depositors' guaranty fund commission. The depositors of a failed institution are paid as soon as the public examiner can determine the amounts due them. All the foregoing provisions were taken bodily from the Nebraska law.

The South Dakota law has introduced an innovation in that it makes no provision for extra assessments. Instead of extra assessments it provides for the issuance of interest-bearing certificates in the event that the guaranty fund becomes depleted. It apparently assumes that over a long period of time the regular assessment of one fourth of one per cent will be safely above the average rate of loss. In the meantime the interest-bearing certificates will take care

of any abnormal loss. This assumption of the law is probably warranted, for, as already indicated, the average annual rate of loss in the national banking system since the Civil War has been only one twentieth of one per cent of deposits. If the South Dakota statute is honestly and intelligently administered it seems unthinkable that losses over a long period of time could average annually as much as one fourth of one per cent of deposits.

When passing this guaranty law South Dakota at the same time made more definite and stringent the criminal provisions for the violation of the general banking laws. In this connection South Dakota has introduced another novelty. The law authorizes the public examiner to offer rewards not to exceed $300, to be paid from the guaranty fund, "for the apprehension and production of any person accused of violating any of the provisions of this act." [1] This is the first attempt on the part of any of the guaranty laws to make the banks bear a part of the expense of bringing bank wreckers to justice.

The South Dakota guaranty law became effective January 1, 1916. With the collection of the fourth annual assessment there has been paid into the guaranty fund approximately $900,000. In the meantime two bank failures have occurred. The first bank to fail required $24,000 from the guaranty fund to pay depositors, but when the public examiner liquidated the assets the guaranty fund was completely reimbursed.[2] The second failure required $130,000 from the guaranty fund. At the present time the assets are in the process of liquidation, but the public examiner reports that the indications are that there will be very little loss.[3] The state banks seem to feel that the law is attracting business, although it is as yet too early and conditions have been too abnormal to give any very con-

[1] *South Dakota Banking Laws*, article 3, section 22.
[2] *Thirteenth Biennial Report of the Public Examiner*, p. 14.
[3] Letter from the public examiner, March 13, 1920.

clusive statistical proof of this. The law unites most of the strong features of the laws in the other states, and its degree of success will depend in large part on the efficiency of its administration.

3. *The Mississippi system.* The case of Mississippi furnishes another striking example of the resurgence of the deposit-guaranty movement. The events leading up to the enactment of the Mississippi law are well described by Mr. Thornton Cooke:

It may seem a far cry from the boll weevil to deposit guaranty. But remembering the relation of the chinch bugs in the Missouri Valley to the free silver movement of the nineties, one realizes that an insect may be a cause of financial legislation proposed or enacted. For several years, in Mississippi south of the 33d parallel, the cotton crop had been almost destroyed by the boll weevil. In a typical county, Pike, the normal crop of 25,000 bales fell to 3600 bales in 1913. In other sections of the state the crop was injured by the army worm, and in the Delta section by overflows from the Mississippi River. At the same time the state banks were running without supervision. The statutes were not entirely lacking in banking provisions, and some of the provisions were in themselves very good, but there was no bank examination and no verification of reports. "In a word," says a Mississippi legislator, "Mississippi state banks were simply chartered by the state and turned loose to do business just as they would."

It was inevitable that many banks should fail. There is no official list of the failures, but a list privately compiled showed 22 bank failures in 1912 and 1913 and 7 more early in 1914. The deposits were not ascertained in all cases; so far as known, they amounted to $4,600,000. The number of banks reporting to the state auditor fell from 342 in June, 1911, to 306 in June, 1914. National banks increased in number from 31 to 37. There was an attempt in the legislature of 1912 to enact a banking law. It failed largely because the Senate and House could not agree on the method of selecting the bank examiners. A majority of the Senate wished the examiners to be appointed, while the House wanted them elected by popular vote.

By 1914 it was evident that something must be done. There was a bank failure just as the legislature met, and failures occurred all through the session. Not satisfied now with a bill for

safeguards and supervision, many legislators insisted from the start on the guaranty of bank deposits. The Mississippi Bankers' Association, with much the same arguments that had been used before the legislatures of other states, opposed the guaranty sections to the end. It is possible that if the members of the Association had foreseen the ultimate adoption of deposit guaranty, they could have made participation optional with the banks, and could have provided for appointive, instead of elective, bank examiners. After a long struggle a bill was finally passed in March and was signed by the governor March 9.[1]

The act of March 9, 1914, created a banking department in many respects unique. The state is divided into three districts corresponding to the three supreme court districts and a bank examiner for each district is elected by popular vote. The three examiners elected choose one of their number as chairman and a majority of the board constitutes a quorum. Each bank examiner is supreme in his own district. The function of the board and its chairman is largely to secure some degree of coöperation among the three examiners.

It has been said that these three examiners are elected by the people. The Mississippi legislature required the state banks to make good each other's bad debts, but in the same breath refused the banks any voice in their own regulation. This was both unwise and unjust, as is well shown in the first three years in Oklahoma when the state banking board consisted of five state officials. But Mississippi does attempt to insure the election of men whose technical training fits them for the position. Before a man can become a candidate for the position of examiner he must have passed a qualifying examination. This examination is conducted by a board of bank commissioners. This board consists of three persons.

One is appointed by the governor, who shall be a successful banker and business man; one by the attorney-general, who shall

[1] *Quarterly Journal of Economics*, 1914, 29:419–20.

be an experienced lawyer; and one by the auditor, who shall be an experienced accountant.[1]

This board of bank commissioners

> shall hold a written examination in the office of the banking department on the subject of accounting, the theory and practice of banking and the banking laws of the State of Mississippi, and the federal banking laws. To each person who attains a grade of 75 per cent or more on said examination and who furnishes satisfactory evidence of good moral character, and the possession of all the other qualifications set out in section 3 of this act, the said examining board shall issue a license to become a candidate for state bank examiner, which license shall be good and valid for four years and no longer.[2]

The successful candidate at the election becomes the bank examiner for his district.

It would seem that there are grave doubts as to the wisdom of this whole complicated procedure. The technique of bank examining is an accomplishment attained largely through years of experience in judging men and values. Many men might easily pass the above examination and yet be unfit for bank examiners. Further, the term of office is only four years and through the exigencies of politics it may easily happen that an examiner will be turned out of office just when he is becoming a valuable official. Finally, it is hard to see any reason why examiners should be elected by popular vote, for, where banks are compelled to guarantee each other's deposits, the evil effects of incompetent bank examiners will fall on the banks, not on the public.

The banking law became effective immediately upon its passage, but the guaranty feature of it did not become compulsory until May 15, 1915. Between March 9, 1914, and May 15, 1915, banks so desiring could protect their deposits after subjecting themselves to a rigid examination and paying the required assessments. After May 15, 1915, the guaranty feature became compulsory on all banks.

[1] *Mississippi Banking Law*, section 4. [2] *Ibid.*, section 5.

Mississippi had profited by Oklahoma's folly in grafting a guaranty system on to a lot of struggling banks and wisely gave the newly created banking department a year to make examinations and weed out insolvent banks.

It has already been pointed out that South Dakota adopted almost bodily the Nebraska system. It is interesting to note that Mississippi was powerfully influenced by the Kansas law, the only important exception being that a compulsory system was adopted. All deposits not otherwise secured and not drawing interest at more than four per cent are protected by the guaranty fund.[1] The annual assessment in Mississippi is one twentieth of one per cent of average daily deposits, but in computing the amount of these deposits the bank's capital and surplus are subtracted.[2] However, the minimum assessment must be at least $20. These assessments continue until the fund amounts to $500,000.[3] In case of emergency four extra assessments of one twentieth of one per cent may be made in any one year.[4] All assessments are paid to the state treasurer and held by him in the state depository banks.[5] As an evidence of its good faith each bank must deposit with the state treasurer United States, state, or municipal bonds, or cash, to the amount of $500 for every $100,000 of deposits or fraction thereof, minus its capital and surplus.[6]

When a bank becomes insolvent it is closed and liquidated by the bank examiner. The depositors are not paid at once, but are given interest-bearing certificates.[7] As the examiner realizes upon the assets of the bank he applies the proceeds to the payment of these outstanding certificates. If the liquidated assets, including the double liability of stockholders, are not sufficient for this purpose, the bank examiner certifies to the board of bank examiners the bal-

[1] *Mississippi Banking Law*, section 38. [2] *Ibid.*, section 35.
[3] *Ibid.*. [4] *Ibid.*. [5] *Ibid.*.
[6] *Ibid.*, section 34. [7] *Ibid.*, section 36.

ance yet due and this board makes a requisition on the state treasurer to pay the deficiency from the guaranty fund.[1] It will be noted that all of these provisions are the identical provisions of the Kansas law.

On January 1, 1920, the guaranty fund consisted of $178,587.41 in cash, $70,500 invested in bonds, and $92,-483.57 invested in guaranty certificates. Since the failed banks for which these certificates were issued have not been liquidated it is patent that the last item, $92,483.57, may be a heavy charge against the guaranty fund. Since the law became effective five banks whose deposits were guaranteed have failed. Under the law certificates were issued to depositors at once, but since the banks have not been fully liquidated, it is too early to tell what percentage of these certificates will be a charge against the fund. In order to relieve the banks that were carrying these guaranty certificates the banking department made special assessments and with the proceeds took over some of the certificates. Besides the regular annual assessment of one twentieth of one per cent two special assessments each of the same amount were made in 1918 and three in 1919. The board of bank examiners estimates that the regular assessment to be collected in January, 1920, will be sufficient to take up all of the outstanding guaranty certificates. The board also estimates that the assets upon which these certificates have claim amount to $79,000. Counting the total collections to date, therefore, it would seem that the net loss through bank failures will cost the guaranty fund approximately $350,000.[2]

The trouble Mississippi has experienced with bank failures is an inheritance from the days when her state banks operated without supervision. It is true that a year was allowed the bank examiners to make examinations and get

[1] *Mississippi Banking Law*, section 36.

[2] The material for this paragraph has been obtained from the Biennial Report of the Department of Banking, 1918–19. The estimate of the net loss is made by the writer.

the banks into a condition to come under the protection of the guaranty law, but the problem of determining which banks to admit and which to liquidate was a hard one, and it now seems clear that some were admitted that should have been closed. Notwithstanding these failures both the banks and the public appear to be well satisfied with the beginning they have made.

4. *The Washington system.* Attention has already been directed to the anomalous fact that bank-guaranty legislation was for a time restricted to a series of contiguous states extending from North Dakota south to the Gulf. In 1914 Mississippi extended the idea into the Old South, and three years later the State of Washington carried it to the Pacific Coast. It was natural that states neighboring Oklahoma should copy such legislation, for in the early stages of the movement it was felt that the Oklahoma banks were working at a great advantage. But Washington was far removed from this influence, and for this reason it is of interest to watch the development of the movement in this latest convert to such legislation.

In Washington deposit guaranty long had its friends who were watching the operation of the laws in the other states. At two different sessions of the legislature prior to 1917 guaranty bills were presented, only to meet defeat. But the sentiment for such a law was gradually gaining ground, and the friends of the proposition felt sure of victory when the legislature convened in 1917. It so happened, however, that while this legislature was in session, four bank failures occurred in the city of Seattle, and the fate of the pending bill was no longer in doubt.

For the most part Washington copied the Kansas law. The law is voluntary, banks entering and withdrawing from the system as they see fit. The administrative machinery of the system consists of the guaranty fund board which is composed of the governor, the state examiner, and

three other members appointed by the governor. Two of these last three members must be officers or directors of member banks.[1] A bank to be eligible to membership must have an unimpaired surplus equal to ten per cent of its capital stock, must have been in existence at least a year, and must subject itself to "a complete and rigid examination."[2] When it complies with these requirements the state bank examiner issues to it a certificate which states that its deposits not otherwise secured are guaranteed by the Washington bank depositors' guaranty fund. However, "the guaranty provided in this act shall not apply to a bank's obligation as an endorser upon bills rediscounted, nor to bills payable, nor to money borrowed from its correspondents or others, nor to deposits of public funds in excess of its capital and surplus."[3]

The guaranty fund consists of one half of one per cent of the total annual average daily deposits eligible to guaranty of member banks. As a pledge for the payment of their assessments member banks must deposit securities to the face value of $1000 for every $100,000 of deposits or major portion thereof.[4] Should the guaranty fund become reduced by more than twenty-five per cent of this amount the guaranty-fund board "shall determine whether it is necessary or expedient to make an assessment on the member banks," but no more than one half of one per cent of the total amount of average daily deposits eligible to guaranty shall be assessed in any calendar year.[5] If a member bank is found to be violating the law it is given thirty days in which to comply, and, if it fails to do this, it loses its membership and forfeits to the guaranty fund both its assessments paid into the fund and the bonds that were pledged as security for the payment of its assessments. The state bank examiner takes charge of a bank when it

[1] *Guaranty Fund Act of the State of Washington*, section 3.
[2] *Ibid.*, sections 6 and 8.
[3] *Ibid.*, section 10.
[4] *Ibid.*, section 2.
[5] *Ibid.*, section 11.

becomes insolvent, and, upon proof of claim, issues a warrant to every guaranteed depositor. Should there not be sufficient money in the guaranty fund to pay warrants, they draw interest at five per cent until called.[1]

The act was signed by the governor March 10, 1917. Before the end of the year 46 banks and 3 branches had qualified and been admitted to membership. In 1918 the number joining was 39 banks and 2 branches, and in 1919 it was 19, making a total of 104 banks and 5 branches, or about 39 per cent of the banks of the state. On December 31, 1919, the guaranty fund amounted to $245,338.55.[2]

In 1918 the state bank examiner made the following comment on the operation of the law:

> The one year and six months of operation of the guaranty fund has demonstrated that the benefits resulting to the banks participating in the system are considerable and its success is entirely assured. From a dollars and cents standpoint it is firmly believed that the increased earnings accruing to the banks as a direct result of the increase of business because of membership in the fund will more than balance any expense connected with it.[3]

As yet it is too soon to give definitive statistical proof of the issues raised in the above quotation. In drafting her law Washington has profited by the experience of other states, and it now remains to be seen whether the state realizes the equal importance of its unflinching enforcement.

5. *The North Dakota system.* The North Dakota and the Washington bank-guaranty laws were approved on the same day, namely, March 10, 1917. Agitation for such a law in North Dakota covered a period of nearly thirty years, but it was only after the passage of the South Dakota guaranty law that it made much headway. A

[1] *Guaranty Fund Act of the State of Washington*, section 18.
[2] *Thirteenth Annual Report of the State Bank Examiner*, p. 7.
[3] *Twelfth Annual Report of the State Bank Examiner*, p. 8.

farmers' legislature was responsible for the law, although a goodly number of bankers favored the measure because they believed the South Dakota law was attracting deposits and they naturally feared the competition of the guaranteed banks in their neighboring state. As a whole, however, it is probable that the bankers opposed the bill.

In the main the North Dakota law resembles the Nebraska and South Dakota guaranty statutes. The law is compulsory; all banks must qualify and pay assessments or liquidate. The North Dakota system is administered by the Depositors' Guaranty-Fund Commission which is composed of the governor, the state examiner, and three other persons appointed by the governor. Persons eligible to appointment to these three places on the commission "shall have had at least five years' experience in the management of some bank or banks located within the State of North Dakota and shall be an official of some bank which is directly affected by the provisions of this Act." [1]

All deposits not otherwise protected are subject to guaranty, and no additional security is required from banks becoming a public depository. The annual assessment which each bank must pay consists of one twentieth of one per cent of its average daily deposits for the preceding year. This assessment continues until the guaranty fund reaches one per cent of the average daily deposits. Should the fund become depleted below three fourths of one per cent of these deposits, special assessments may be made, but no more than four special assessments of one twentieth of one per cent may be made in any one year.[2]

The banks are given the custody of the fund. Each bank is notified as to the amount of its assessments and it then credits this amount to the depositors' guaranty fund to be paid on demand to the Depositors' Guaranty-Fund Commission. North Dakota requires no special deposit of

[1] *North Dakota Depositors' Guaranty Law*, section 1.
[2] *Ibid.*, section 7.

cash or securities from banks as a guaranty for the payment of their assessments, but failure to credit the fund with its assessment makes a bank subject to a daily fine of ten dollars for the first twenty days and at the end of thirty days the state examiner must liquidate the recalcitrant bank.

When a bank failure occurs, the state examiner ascertains the amount due each depositor. He then determines the proportionate amount necessary to draw on each of the remaining solvent banks to pay the depositors and certifies this information to the Depositors' Guaranty-Fund Commission. The treasurer of the commission then draws against the banks and pays the depositors. Should the fund be unable to meet the loss, a certificate of indebtedness, negotiable in form and bearing five per cent interest, is issued in favor of the insolvent bank.[1] This certificate becomes due and payable on the first day of March next succeeding the date of issue and is paid out of the first money accruing to the guaranty fund. Banks are not permitted to pay, directly or indirectly, more than five per cent on deposits unless authorized by the Depositors' Guaranty-Fund Commission, and in no case shall the rate exceed six per cent.

On March 1, 1920, the guaranty fund amounted to $77,843. To that date one bank had failed and the state examiner estimates that the loss will be about fifteen thousand dollars. This three-year period of the law's operation has witnessed rapidly rising prices, and when prices are advancing the assets of banks are of course favorably affected. The period has been manifestly too abnormal for a test of the law.

For a few years following the enactment of the first four guaranty laws it was quite generally believed that the movement was only an ephemeral flurry. The passage of the Mississippi, South Dakota, Washington, and North Dakota laws, some five years later, shows that this idea

[1] *North Dakota Depositors' Guaranty Law*, section 15.

must be materially modified. Of late years there has been persistent agitation in Congress for the guaranty of deposits in national banks, and the Comptroller of the Currency in his Report for 1917 urges the guaranty of deposits in these banks where the deposit does not exceed $5000 for any one individual. The modern guaranty movement, extending over a period of twenty-five years, has been most active when stimulated by numerous bank failures. Bank failures show a great tendency to concentrate not only because of their relation to periods of economic depression, but also because of the tendency of one bank to pull down others with it. This concentration of failures also serves to concentrate public attention. In the meantime the actual operation of guaranty laws in eight states is rapidly giving us facts as to the practicability of extending the principles of insurance to this field of bank losses. The experience of South Dakota, Mississippi, Washington, and North Dakota serves to show that a proper conjuncture of events may at any time bring other states face to face with the same proposition.

CHAPTER VIII

THE EFFECTS OF THE LAWS

1. *The purpose of this chapter.* The review of the various bank-guaranty laws has now been completed. In giving an account of these laws little more has been attempted than to set forth the facts as to the workings of the laws in the several states. With these facts before us it is now our purpose, by bringing them together, to see what light they throw on some of the much-mooted questions of bank guaranty.

At the very outset great difficulty is encountered. In no two states is the guaranty system exactly the same. Again, the social and economic conditions in these states differ widely. Some states have been members of the Union for over half a century; they have recovered from the youthful weakness incident to their boom days, and are now pressing forward on sane and conservative lines. In one state the reverse of this has been found — that its guaranty law was grafted on to a banking system which scarcely existed and that its operation has been confined to the period covering the most acute growing pains of the new state. These diverse conditions make general conclusions dangerous, but at the same time they make possible a many-sided view of this banking experiment in action.

Few questions that have attracted public attention have been more debated than this. Three classes have taken part in this discussion. In the first place, this question passed through one of our most heated presidential campaigns as a prominent issue, where the politicians fought against each other, neither side leaving unturned a stone that might conceal valuable political material. In the second place, the guaranty proposal threatened to touch the

pocket-book of every banker of the country. Some bankers obviously it would help, others it would injure. This provoked among the bankers the most bitter controversy that has ever attended any of our banking and currency discussions. Finally, the professional economist has passed this subject in review. This discussion sharply defined the arguments for and against such a law, and now, after twelve years of the operation of the various laws, we are in possession of many facts by which to test the validity of such arguments.

2. *The necessity of guaranty legislation.* The first point on which this controversy centered was as to the necessity of such legislation. One side contended that undue emphasis was being placed on the hardship which depositors suffer from loss of deposits. The surprisingly low rate of loss to depositors since the establishment of the national banking system was pointed out; also that the establishment of postal savings banks would bring facilities for the safe-keeping of savings to the door of every citizen of the land. Bank guaranty is primarily for the protection of commercial deposits and the contention was that such deposits did not warrant such action. As a rule a commercial deposit is the result of an individual taking collateral to a bank and getting a loan on it. The bank takes the collateral, and, instead of giving to the individual currency, credits him with a deposit against which he has a right to draw. A guaranty of such a deposit is a guaranty that the bank will meet its loan, and a guaranty law is nothing more than a law requiring banks to guarantee each other's loans. The opponents of the scheme maintained that there is no more justification for a fund to guarantee such loans than for a fund to guarantee loans made between individuals.

Even a cursory examination shows that this argument is extreme. First, as regards the contention that losses occasioned by bank failures have been exaggerated. It is

quite impressive to cite the fact that the average annual loss to depositors of national banks since 1863 has been only one twentieth of one per cent of deposits. But when the situation is viewed from another angle it takes on a different aspect. From 1863 to 1916 national banks to the number of 566 have failed with net losses to depositors of over $51,000,000.[1] This means that depositors of national banks have lost on the average nearly a million dollars a year. Moreover, when it is considered that state banks outnumber national about two to one and that their supervision is usually much less efficient, it is evident that the total losses from all bank failures assume an imposing figure. It is, therefore, altogether arbitrary to say that losses have been so insignificant as to be unworthy of consideration.

The harm done by bank failures is accentuated by the fact that they have a tendency to concentrate in periods of depression when the community is ill-prepared to sustain the shock. This is shown by the fact that in Kansas and Nebraska between 1890 and 1896 over a hundred banks failed in each state. The effect of deposit insurance is to scatter this shock over longer periods of time. From the standpoint of society there is no question but that this is highly desirable. The only question is whether the possible effect of guaranty laws in stimulating reckless banking more than offsets the salutary effects of such laws. These questions will shortly receive full consideration.

It is also an exaggeration to say that there is no more reason to guarantee bank loans than there is to guarantee loans between individuals. Since a bank, in common with other corporations, is a creation of the law, it becomes what might be called a quasi-public institution. Aggregations of persons and capital doing business under the corporate form are given a legal and consequently a public recognition that is a valuable credit asset, and the state, especially in

[1] *Report of the Comptroller of the Currency*, 1915, vol. II, pp. 108–09.

this country in the case of banking corporations, has always made the attempt to see that this credit was not abused. Furthermore, probably more than three fourths of all deposits are created by loans and the deposit currency that rests on these loans transacts a large part of the business of the country. Because of this rôle played by deposit currency, the business stability of a community becomes intimately connected with the stability of bank loans. Justice Holmes, of the United States Supreme Court, stated the case as follows:

> It may be said in a general way that the police power extends to all the great public needs. . . . Among matters of that sort probably few would doubt that both usage and preponderant opinion give their sanction to enforcing the primary conditions of successful commerce. One of those conditions at the present time is the possibility of payment by checks drawn against bank deposits, to such an extent do checks replace currency in daily life. If, then, the legislature of the state thinks that the public welfare requires the measure under consideration, analogy and principle are in favor of the power to enact it. It is asked whether the state could require all corporations or all grocers to help to guarantee each other's solvency, and where we are going to draw the line. But the last is a futile question, and we will answer the others when they arise.[1]

Banking institutions gather in the funds that the public is temporarily not using and lend to private parties the credit which the bank erects on this foundation. Because of their intimate relation to the public banks have become quasi-public institutions. The state in throwing safeguards around these institutions can make banks as safe as the men who run them. It is this personal element in banking which causes the trouble. The law requires of each banker that he be honest and the possessor of good judgment, and the state employs bank examiners and other officials to ascertain these qualities. But no laboratory method has been devised by which to determine without the possi-

[1] Noble State Bank v. Haskell, 219 U.S. 104, 110, 112.

bility of error the good judgment or the honesty of men. The average individual is helpless in protecting himself from this quarter. He may have a choice as to where he will deposit, but the fact remains that he must deposit somewhere. The fact that expert bank examiners, and even the directors themselves, are often deceived shows that this freedom of choice is an empty consolation to the individual. No banking regulations have yet been devised which will prevent incompetent and unscrupulous men from wrecking banks. The guaranty laws have cut this Gordian knot by requiring banks mutually to insure their deposit liabilities.

3. *Bank guaranty as a cure for panics.* It will be remembered that Oklahoma presented bank guaranty to the world as a panacea for panics. Being twelve years removed from the panic it is difficult to realize the appeal which this argument made at the time. The newspapers and periodicals of that day abound with the expressions of both bankers and individuals who implicitly believed that panics would be impossible if people had the assurance that their deposits were safe. This was the theory of the argument, and while there have been no panics to test it, the operation of the laws shows pretty conclusively the limitations of such a device as a panic cure.

Panics can be prevented in only two ways, namely, either by removing the causes or by cutting short the panic at its inception. Even a casual consideration of the causes will suffice to show that bank guaranty could in no way eliminate them. Like death, panics may result from many causes, and bank guaranty is as likely to aggravate as to alleviate some of them. It is generally conceded that one of the principal causes of panics is speculation and the over-extension of credit. The speculative propensity is one of the weaknesses of human nature. When we become so adept at the art of lawmaking as to be able to legislate

mankind into the kingdom of Heaven, then only may we be able to construct a law which will deprive him of this most human characteristic. As for the over-extension of credit it is possible that bank guaranty is an additional irritant. Bank deposits are the basis of the extension of credit and in so far as such a law draws money out of hoarding and augments the deposits of banks, just so far does it aggravate this cause of panics. Other causes, such as widespread crop failures, earthquakes, and destructive wars, it is evident are not susceptible to any such artificial remedies.

In fact, bank-guaranty philosophy makes no pretensions to cure panics in any such way. Lack of confidence is the formula which sums up the diagnosis of this theory. In considering this phase of the subject much confusion may be avoided by distinguishing between a "run" on a bank and a panic or financial crisis. A run on a bank may occur when general credit conditions are normal and healthy, the depositors having become frightened by a rumor that their particular bank is insolvent. The trouble is generally caused by depositors whose bank account represents savings. The cause of such a run is simply a lack of confidence, the depositor fearing that all or a part of his deposit will be lost. It is easy to see what effect a guaranty law would have on such a situation. Over eighty banks have failed in the various states with guaranty laws, and in no case was there anything which resembled alarm on the part of depositors. If there is one thing that stands out above all others, it is that the operation of the guaranty laws assures a banker that he can go home at night and sleep, knowing that his institution will not be besieged the next day by his depositors.

But a panic, or what is better known as a financial crisis, is a very different matter. "Every experienced man of affairs knows that the material for a financial catastrophe is collected by previous years of extravagance, over-

trading, and expansion of credit; and that it is only an accident whether it is this or that event which touches off the powder magazine."[1] It has already been indicated how a bank may support a very heavy deposit-credit by means of the check system and a skillful marshaling of its assets. Since bank credit is called into existence largely by the granting of loans its fluctuations serve as an indicator of business activity. A period of prosperity is characterized by a certain business exhilaration; business begets business, and when the whole industrial organization is throbbing with energy the credit system is subjected to a severe strain. Credit is healthy only when the purposes for which it was extended ripen into utilities that will liquidate the loan. The great danger of a period such as we are considering is that the confidence of enterprisers will develop into recklessness, with the result that when the day arrives for the realization of their dreams it will be revealed that they have overreached themselves. It is evident that a sufficient number of these failures will carry down with them the financial institutions that have been backing them with credit. Because of the interdependence of modern financial institutions the shock of a few large failures may be felt throughout the country. With credit over-extended the law of self-preservation becomes the first law of banks, and the temporary inability of banks in financial centers to give assistance to their correspondents precipitates a temporary paralysis throughout the whole credit system.

Such is the disease to which bank guaranty addresses itself as a cure. Deposits, as already indicated, represent either the actual deposit of money or the creation of loans. Oklahoma gives conclusive proof that a guaranty law will prevent a run on the former kind of deposits, because it overcomes the lack of confidence on the part of the public that such deposits will be lost. But when it comes to deposits created by loans lack of confidence has not so much

[1] J. Laurence Laughlin, *Banking Progress*, p. 95.

to do with the case. Here the great harm is done when credit is cut off, resulting in the prostration of business. These deposits do not represent surplus savings that can wait; they represent loans to business men who want their money or its equivalent at very definite times to meet their obligations. Bank guaranty might meet this situation in either or both of two ways. One would be to maintain a fund sufficiently large that the credit of banks would be saved from a collapse; the other would be the possibility that in a time of crisis, if all deposits were guaranteed, the public could temporarily use bank checks as a kind of currency, and thus obviate, for the time being, the necessity of presenting them for payment. Let us consider these propositions.

Since bank guaranty professedly makes no attempt to remove the causes of financial crises, it might stop them by maintaining a fund sufficiently large to prevent a break after the storm has gathered. The problem is not only that of meeting the losses occasioned by insolvent banks, but also of making instantly available the temporarily paralyzed credit of all banks. Obviously a fund to accomplish this must be very large. Assuming that such a fund were thirty-three cents on the dollar, in 1911 in Oklahoma it would have amounted to $18,000,000 or nearly twice the total capital stock of the banks. Oklahoma has plainly shown that the fund cannot be much less than this, for there it was attempted to accumulate a fund equal to five per cent of deposits and a few bank failures wiped it out of existence in a few months. It is also patent that in a time of financial panic interest-bearing certificates could not be used with which to borrow money to avert the crisis. In a financial crisis currency is at a premium and nearly every one is hysterically trying to borrow, not lend. Consequently, it is plain that it would be impossible to borrow money on the gigantic scale that would be necessary. Bank guaranty as a panic preventive by amassing a fund

to galvanize the temporary paralysis of credit is chimerical, because a fund sufficient to meet commercial deposits would take all the money out of circulation; and if such a fund could be amassed the banks could not afford it. Texas, Nebraska, and South Dakota are collecting modest funds with which they expect to pay depositors at once. If they succeed in preventing a concentration of loss they will probably be able to pay depositors at once, but in a time of panic and a universal suspension of credit such funds will go but a short way. Kansas, Mississippi, and Washington have given up the panic-cure idea altogether and only attempt ultimate payment.

There yet remains the second consideration, namely, that if all deposits were guaranteed, the public, in a time of crisis when checks temporarily could not be honored at banks, would find a use for checks by passing them from hand to hand, thus obviating, for the time being, the necessity of presenting them for payment. To the extent that this would be possible bank guaranty, while not a panic cure, would be at least a valuable palliative. It is difficult to foretell to what an extent such a practice might develop. The great obstacle to be overcome is the fact that checks by custom have a restricted circulation and are almost immediately presented for payment. The reason for this restricted circulation is not only the uncertainty as to whether the bank can honor the check, but more particularly the uncertainty as to the genuineness of the check and the further uncertainty as to whether the drawer has, and how long he will have, a deposit in the bank to cover it. Crises are so widely separated and of such short duration that this customary use of checks would with difficulty be broken down quickly enough to give much relief. However, in every community there are individuals and business firms that have a recognized standing and credit, and where these firms mail out their checks and it becomes a question for the time being of receiving payment in this

form or nothing, their creditors could probably make these checks circulate temporarily.

4. *Conservative bankers watching the reckless.* One of the fascinating arguments for bank guaranty was that, if all banks were required to contribute toward a fund with which to meet losses, the honest and conservative bankers would keep a watch on the reckless and dishonest, and that this inside pressure would force the rascals out of business. The advocates of the scheme maintained that the banking system would become self-regulating and thus relieve the state of many perplexing problems. Here again they seem to have reckoned without the host. Practically every failure in Oklahoma, Texas, and Kansas has been caused by incompetency or dishonesty, and there is not a case on record where another banker has raised his finger against the proceedings. Norton and his associates increased the deposits of the Columbia Bank and Trust Company about seven hundred per cent in less than a year, yet not a banker of the state raised a whimper. When this bank went down it was the immediate cause of two other failures, yet the officials of these two banks let Norton and his associates continue on their mad career without even registering a protest. It would be hard to imagine a more spectacular piece of dishonest banking than the attempt of Abner Davis to finance the Putnam City project with the funds of the Night and Day Bank. Governor Haskell, the chairman of the state banking board, knew of it, and it is certain that the well-informed bankers of Oklahoma City understood what was going on; yet there was no protest. J. S. Spotts, the principal owner of the defunct First State Bank of Kopperl, Texas, had already served a term in the United States penitentiary for the violation of the national banking laws, but he encountered no opposition from his fellow-bankers in reëntering the banking business in Texas. Flack, the wrecker of the Abilene Bank, Kansas,

was one of the most popular bankers in Kansas, and he was out of the state two weeks before his associates realized what he had done. The other failures in Oklahoma and Texas are in the main but a repetition of this same story.

But, after all, the apparent breakdown of this theory is not to be caviled at. There is no disputing the fact that under compulsory deposit insurance it is to the interest of the careful bankers to have the reckless and the incompetent eliminated. This fact is self-evident; where the bank-guaranty theorists went astray was in thinking that the proposition would work itself out through a system of espionage. In the field of labor legislation there is a curious case where this same idea was given a trial. The Industrial Revolution caused the problem of industrial accidents to assume new proportions. The following quotation shows how it was proposed to meet this new problem by an unflinching application of the fellow-servant doctrine: "But it is an essential part of the old theory [common-law doctrine], that an unsparing application of the fellow-servant doctrine will force employees to exercise a ceaseless surveillance over one another, and thus reduce the number of accidents to a minimum." [1] This part of the general fellow-servant doctrine was that by refusing the victim damages when his injury was caused by a fellow-servant, each laborer would watch that his fellow-laborers did not become careless and reckless. We now know how fantastic it was to suppose that the great problem of reducing industrial accidents could be solved by inside pressure of this kind. Looking back over a hundred years we now see that the pressure was exerted on the state, and the state brought relief by enforcing the adoption of safety appliances, guards for machinery, the principle of employers' liability, and other such remedial measures. So with bank guaranty. After studying more than eighty bank failures in the vari-

[1] Adams and Sumner, *Labor Problems*, p. 482.

ous states it almost provokes a smile when it is recalled how the propagandists of 1908 expected to eliminate bad banking by having the conservative bankers keep their eye on the reckless. In justice it must be said that there was an element of truth in the theory, only it worked out in practice quite differently from what had been planned for the simple reason that the practice of spying on others is repugnant to the ordinary man. When the assessments in Oklahoma in 1911 reached on an average over six per cent of capital stock, the bankers, instead of individually watching each other, brought such pressure to bear on the state administration that the politicians were forced off the state banking board and the bankers themselves took over the supervision of banks. Thus, instead of a system of private espionage, the bankers took over a publicly constituted board whose duties were to pry into the affairs of each bank. So in earnest were the bankers that they have organized a banking supervision, which for efficiency and watchfulness is probably not surpassed in the United States.

5. *Bank guaranty as a promoter of reckless banking.* One of the most effective arguments produced was that bank guaranty would wreck any banking system because it made all banks equally safe in the eyes of the public. Free banking is based on the theory that the asset which draws business to a bank is its reputation for foresight, prudence, and care in handling funds. The depositor, realizing his risk, seeks conservative banks, and the banks in order to get business are constrained to careful methods. Now bank guaranty comes along and reverses this theory. The depositor no longer seeks the safest bank, but the bank that will give him the most liberal terms. It was argued that the wild-cat banking that would ensue would plunge the whole banking system into ruin.

Before this proposition can be effectively discussed a

more scientific statement of the case must be made. It must be remembered that this is a matter of insurance, and, in terms of insurance, this contention that the wild-cat banking engendered by such a law would plunge the whole banking system into ruin is simply a statement that the "moral hazard" of this insurance will, from the very nature of the case, defeat the insurance.

In order to consider this question more advantageously a broader view of the insurance field must be taken that we may be enabled to understand more fully this "moral-hazard" element. It is well known that some men will commit suicide in order that some one else may get their life insurance. If the moral hazard in fire insurance had not been controlled it is probable that fire insurance would have proved the world's greatest game of swindle. It costs society heavily to control this moral hazard, but fire insurance fills such a long-felt need that the benefits far outweigh the costs. Consequently, fire insurance companies will indemnify only actual loss, and often they insert the so-called three-fourths value clause which further restricts the amount that may be collected on any loss. There are many other devices designed for this same general purpose, but enough has been said to indicate the necessity of these safeguards. In sick insurance we have malingering; in accident insurance, self-inflicted injury; while in insurance against unemployment, simulation must be guarded at every turn. Not only is there this hazard due to the moral obliquity of the party insured, but there is also that inevitable relaxation of vigilance which is present in all kinds of insurance. These tendencies must be curbed or insurance, becoming corrupt, will degenerate into a means of exploitation.

But while there is always the tendency to use insurance for private advantage, there are certain social forces which insurance sets at work that have a countervailing effect. I. M. Rubinow states this fact as follows:

Whether it be prevention of crime, disease, accident, or fire, or any other hazard, it is through social effort that substantial results have been obtained within recent years. It is in efficient police protection and not individual prudence in staying home after dark that we put our hopes of safety. Regulation of dangerous processes, measures of public health, a sound employment policy, fire regulations — these are all social forces upon which we depend to make for a prevention of hazard, for a safer life. . . . But as to the preventive work carried on because of insurance there can be no doubt. Fire insurance has resulted in stricter building laws, in better fire-extinguishing facilities, in development of automatic sprinklers; compensation insurance has given a tremendous stimulus to better industrial safety; health insurance in Europe has stimulated better care of the sick and convalescent (which, of course, is truly preventive work), and unemployment insurance has stimulated better provision for public employment offices.[1]

Bank-deposit insurance will have a tendency to relax the vigilance of the depositing public. But this is of little consequence. The theory assumes that the public has perfect knowledge of all the complex ramifications of the modern banking business, and consequently can govern itself accordingly. It has been pointed out repeatedly that this is far from the truth. The truth is that the average depositor knows very little regarding the operation of the modern bank, and that effective state supervision is now the great palladium of public safety.

But there yet remains the contention that under a guaranty law a reputation for foresight and prudence in handling funds has lost most of its significance to a banker as a business-getter. Ancillary to this is the inference that a reckless straining after abnormal profits will tend to replace conservative banking. This is one phase of the moral hazard of this insurance. The attempt will now be made to ascertain whether the practice comports with this theory, and to what extent the operation of the laws tends to set in motion social forces that counteract this moral hazard.

[1] *The New Republic*, July 27, 1918, pp. 365–66.

The evidence which we gather from the seven states is conflicting on this point. In Oklahoma the most positive results have been obtained. There it has been seen that the deposits of the state banks doubled the first year. There is no evidence to show that the public used any great discrimination in choosing banks. It was pretty well known that the officers of the Columbia Bank and Trust Company were speculating in the oil business, yet in the face of this knowledge the extra-liberal policy of this bank increased its deposits at a rate which has few parallels in American banking. Neither is this an isolated case, for the other banks both good and bad received their full share of deposits. Another fact which shows the indiscriminate use of banks is that in the first two years of the operation of the Oklahoma law, 138 new state banks were organized. It is obvious that these new banks had no reputation that would attract deposits, yet these new banks thrived wonderfully even in communities where the competition of the older institutions was strong. This condition, coupled with lax enforcement of the general banking laws, gave every incentive to speculative banking. The lurid banking experiences that followed indicate that the speculator had not failed to take advantage of his opportunity.

On the other hand, the facts which the other states present are quite different. In Kansas the law has so little affected the public mind that only a little over a half of the banks have found it desirable to guarantee their deposits. It has been the large, well-established banks that have entered the system, and so far they are giving little evidence of decay. Nebraska has a compulsory law which apparently is attracting deposits. But there is conclusive evidence at hand that this is not destroying the moral fiber of the bankers. Nebraska and South Dakota are neighbor-states with much the same kind of people, economic life, etc., yet from 1910 to 1914 South Dakota with no guaranty law in operation had fourteen bank failures, while Nebraska

with a very effective guaranty law had only two. In the same time two national banks have failed in Nebraska, and these national failures have revealed far worse banking than the two state-bank failures. Texas has had some bank failures of a very questionable nature, but in this state the problem is complicated by the sudden growth of the state banking system since 1904. In the first ten years about eight hundred new banks were organized, and since in most cases the officers of these banks were inexperienced men it is evident that the guaranty law cannot be held responsible for any large part of the failures in that state.

Oklahoma, therefore, seems to be the only state where we are sure the law has had a tendency to stimulate bad banking. The explanation of this is not far to seek. Here every circumstance encouraged the abuse of the law. The law was passed a few weeks after the panic, as a panic cure. This centered the attention of the public on the state banks. The presidential campaign of the following year further advertised the experiment. The result was a great rush of deposits to the guaranteed banks. The initial law was extremely crude and for a number of years it was blunderingly administered. Oklahoma was experiencing a boom and the lax enforcement of the banking laws made the state a haven for speculative banking. In the beginning every other consideration was subordinated to that of making the law popular. Not realizing that any insurance proposition will degenerate into a swindle when not properly guarded, free rein for a time was given to all who wished to exploit the law. The exemplary punishment which this state received was the logical and ineluctable consequence of this purblind folly. In the three other states where the laws have been in operation for any length of time very different conditions are found. The laws were passed nearly two years after the panic with the result that the public was much less affected. In these three states economic conditions were much more settled, and the banking

systems were on a higher plane. In addition to this every effort was made to guard against the abuse of the laws. Under these changed conditions bank guaranty seems to have had no deleterious effect on the morale of the banking profession. Too much, therefore, should not be made of the Oklahoma case, for if there had been no guaranty law the course of events in that state for a number of years must have been lamentable under any conditions.

In closing the discussion of this question one significant fact must be reëmphasized. While it is true that insurance relaxes the vigilance of the party insured, it is also true that it sets in operation powerful social forces working in the opposite direction. Thus, paradoxical as it may seem, fire insurance is probably the most potent factor in the world working toward fire prevention. It is extremely significant that the same principle is found operating in bank-deposit insurance. Every state that has adopted such laws has at the same time raised its banking standards. Ten years ago Oklahoma had about the lowest banking standards in the country; to-day, almost wholly because of the pressure of the guaranty law on the state bankers, no state in the Union probably has better regulated state banks.

6. *The injustice of bank-guaranty laws.* An objection closely akin to the one we have been considering is that of the injustice of such legislation. It was at this point that the banker was most sensitive and for that reason his point of view will be presented first. The ordinary banker looks upon his bank first of all as a source of profit. These profits are closely related to the size of his deposit accounts, for it is these deposits that give him lending power. The success of the bank depends, therefore, largely on the personality and the driving power of the banker. This naturally makes him individualistic, and like other professional and business men he has a tendency to approach broad questions of policy from the standpoint of his own restricted

business interest. Free banking has existed in this country for nearly a century, and generations of bankers have inherited its extreme individualistic tendencies. Having become accustomed to this state of affairs, the underlying principles of bank guaranty would naturally be repugnant to the ordinary banker. Mr. James B. Forgan, the successful Chicago banker, said more than ten years ago:

> Is there anything in the relations existing between banks and their customers to justify the proposition that in the banking business the good should be taxed to pay for the bad; ability taxed to pay for incompetency; honesty taxed to pay for dishonesty; experience and training taxed to pay for the errors of inexperience and lack of training; and knowledge taxed to pay for the mistakes of ignorance? [1]

Sentiment such as this met a prompt response from many strong bankers. The bank-guaranty specter threatened to turn suddenly into an empty satisfaction the surplus which had been laboriously accumulated to give the bank prestige and the goodwill which years of courteous and conscientious banking had built up. But this is not all. The law would proceed to take the assets of this banker to pay the debts of the banker who with his extravagant promises had taken away the business of the more conscientious banker. The better class of bankers considered this an outrage as great as if the law should require all reputable physicians to contribute toward a fund to be used to repair the damage done by physicians who engage in illegal practices. It was this feeling of the injustice of bank guaranty that made it the most bitter of banking discussions.

In sharp contrast to this rather extreme position is the point of view of society. As viewed by society, the personal element in banking falls into the background, and the institution of banking is considered solely in its relation to the productive process by which society is sustained.

[1] *Guaranty of National Bank Deposits* (pamphlet), p. 3.

This point of view is as impersonal as the other is personal, and its chief consideration is whether the benefits of such a law more than balance its costs. These antipodal views mark the boundaries of any discussion of this question.

The injustice of bank guaranty can best be considered by separating the proposition into two parts. In the first place, it is argued that such a law is unjust in that it places all bankers on the same level and thus turns to naught all of those qualities that are supposed to attract deposits. But it is plain that such a consideration must not be pressed too far. A banker's reputation for honesty and prudence in handling funds would naturally be most conspicuous and would get its fullest reward under a condition where the public suffered the most from corrupt banking. As banking supervision is made more strict it tends to bring all bankers to an equality in this respect. An ideal banking system would be one in which the supervision was so efficient as to preclude absolutely the possibility of loss. But it is plain that in such a case bankers would be on the same equality as under a guaranty law. This argument carried too far would condemn banking regulations in general, and thus run counter to the interests of society.

The operation of the laws has shown that this contention was one-sided in that it overlooked certain important banking customs and habits. It is a well-known fact that most depositors of banks are at some time likely also to be borrowers. Consequently, people naturally deposit with the bank where they are best known. In this way the influence of each bank through its officers and friends reaches out in all directions and controls its own group of depositors. The fact that over two thirds of all the deposits in Oklahoma are in the unguaranteed national banks shows that this is a deep-moving force that the guaranty law has little affected. This undoubtedly explains in large part why the guaranty laws have not attracted deposits to the extent that their proponents predicted.

In this connection it should also be pointed out that a guaranty law does not really put all bankers on an equality. It undoubtedly has a tendency to put banks on the same footing as regards attracting deposits, but in all other ways the field of individual initiative is left wide open. The banker who most successfully eliminates waste in the operation of his plant, and the banker who makes the fewest bad loans, will be rewarded with larger dividends. This fact seems worthy of notice, for the phrase "all banks on the same level" is apt to be misleading.

The second part of this injustice indictment is that good banks are taxed to help pay the debts of the bad. Assuming that bank failures will occur, even under the most efficient supervision, the question is whether there can be any justification for compelling the remaining banks to make good losses in which they had no part. It is a question of public policy rather than that of facts disclosed by the operation of the laws, and for this reason all that can be attempted is to present some of the various aspects of the issues involved.

The first approach to the discussion of this question must lie in a modification of the extreme individualistic view that one bank has no interest in its fellow-banks' activities. This age has been aptly described as an "age of associated effort and associated responsibility," and the banking business has long been recognized as one peculiarly affected with a public interest. In the celebrated case of Munn *v.* Illinois [1] Chief Justice Waite said:

> Property does become clothed with a public interest when used in a manner to make it of public consequence, and affect the community at large. When, therefore, one devotes his property to a use in which the public has an interest, he, in effect, grants to the public an interest in that use, and must submit to be controlled by the public for the common good, to the extent of the interest he has thus created. He may withdraw his grant by discontinuing the

[1] 24 Law Ed., 77, 84.

use; but, so long as he maintains the use, he must submit to the control.

In conformity with the political philosophy of the foregoing quotation banks in this country have long been subjected to special regulations. But prior to the guaranty laws these regulations have been of such a nature as to attempt to enforce the individual responsibility of each bank to its own customers. Legislatures have apparently not considered such regulations adequate protection to the public, and by the enactment of bank-guaranty laws they have compelled the banks to accept associated responsibility for certain of the dangers incident to their business. The question is whether the legislatures by so doing have done a gross injustice as between banks. Freund in his "Police Power" [1] has the following significant sentences regarding the constitutionality of compulsory sickness and old-age insurance:

> Should the law undertake to create an indemnity fund from compulsory contributions of all those whose business or property occasions the loss to be provided against, there would be something analogous to an employers' liability insurance. The objections to such a system would be that an individual would be forced to share in making good a loss with which in a particular case he had no connection, and although he took the utmost precaution to avoid such loss so far as the management of his own property was concerned. But the objection is not conclusive. The controlling consideration is the existence of a risk or danger, which the police power may seek to minimize; and it is reasonable that those who create or maintain the risk or danger for their own benefit should consent to the most effectual means of obviating its harmful consequences; and collective responsibility is a wise and conservative method of meeting the risk, and its imposition should be allowed as a valid condition of the right of keeping a dangerous instrument.

There is another line of approach to this question of justice. If a guaranty law increases a bank's deposits it is evident that this will be at least a partial compensation.

[1] Page 460.

As a matter of fact, it is found that deposits have been noticeably increased in some cases, while in others the influence of the laws has been almost negligible. It may also be that in reality there has been no burden, since the banks may have shifted it on to the public.[1] No banker will admit that such a thing is possible. His assessments are a very painful reality, and if he in turn recoups his losses from some source the operation is so obscure and complicated that he is unconscious of what is taking place. In the short space of twenty-five years Oklahoma has been transformed from a wild prairie to a civilized state. As already indicated a gradual decline in the interest rate accompanies such a transformation. Bearing in mind the subtleties of tax-shifting it seems unthinkable that the onerous guaranty assessments have not to some extent retarded this decline, yet few bankers realize what may have been taking place. The extent to which a guaranty law attracts deposits, and the extent to which the assessments are shifted, have a very direct bearing on the question in hand.

But the consideration of this proposition must be extended to another field. This question of the justice of a compulsory guaranty assessment raises the whole question of the mutual gains from insurance. Because of some temporary responsibility an individual may insure his life for a term of years. If he survives this period it is far from the truth to say that his insurance premium represents a dead loss to him. He wanted temporary protection for some object that was dependent on him, and he cheerfully paid for what he got. So with a bank. An insured bank may prove to be solvent over a period of years, but in the meantime the bank has given to its creditors a very real protection from those forces that might have wrecked it. But the insured bank gains in a yet wider sense. As Governor Cruce has well said, every bank is vitally interested in the stability of financial and commercial conditions. The

[1] For fuller discussion see pages 78–82.

guaranty law in Oklahoma is dissiminating the shock of over fifty failures over a long period of years. All banks in the state have gained from the stabilizing effects of this insurance, and it is quite certain that the national banks have reaped where they have not sown. Consequently, instead of rather harshly saying that honest bankers are taxed to make good the debts of the dishonest, the problem should be approached from the standpoint of the mutual gains from insurance.

Finally, it must be borne in mind that banking is not wholly a private business, for the interests of the bank and the public are peculiarly bound together. For this reason banking takes on a public aspect not found in enterprises of a purely private nature. The question of compulsory deposit insurance becomes, therefore, a matter of public policy. Some persons would preserve the extreme individualism of the business and let the resulting losses fall on the public; others would require the banks mutually to accept the responsibilities of the public nature of their business. Both parties maintain that the position of the other is essentially unjust. In the heat of the debate not enough attention has been given to the fact that both parties have much to gain from deposit insurance. It must be evident that the benefits of this insurance are far-reaching and widely distributed. Since both the banks and the public are large beneficiaries, why should not both help to bear the costs? It is patent, therefore, that the proposal to create the guaranty fund in part from a general tax levy has much to be said in its favor. But before these costs can be equitably distributed, more attention must be paid to the three foregoing considerations, namely, (1) to what extent the banks profit from such a law by having their deposits increased, (2) to what extent the cost has already been shifted on to the public, and (3) the extent of the other mutual gains from this insurance. These are hard questions, but they serve to indicate that this whole matter

of the justice of bank guaranty is far more subtle and complicated than has often been supposed.

7. *The effect of guaranty laws on hoarded money.* One of the claims made for a guaranty law was that it would draw into circulation the money which was being hoarded and to that extent increase the banking power of the country. It was always taken for granted, of course, that there was a great economic gain to be derived from drawing money out of hoarding. The controversy as to the relation existing between the amount of money in circulation and prices never occurred to the persons putting forward this claim. To them the statement that money would be drawn into circulation was in itself proof that the consequence would be an unalloyed gain. The following quotation from Alexander H. Revell shows the general tenor of the assertions made at that time:

> It would at once place the immense amount of money in hoarding into circulation. How much this is, lying in safety-deposit boxes, under carpets, in mattresses, etc., hidden away in the homes and elsewhere, it is impossible to estimate, but the total, it is admitted, would be staggering. This great wasted wealth would be forced into circulation at once by the fact that banks would become absolutely the safest place for its preservation.[1]

It is nearly impossible to exaggerate the degree to which this argument for bank guaranty stimulated the imagination of many people. In fact, the above quotation is rather guarded in tone as compared with some of the more extravagant statements. It was usually assumed that at least one billion dollars was hidden away. In one case it was estimated that the amount in hoarding was equal to fourteen dollars per capita.[2] When it is recalled that the total amount of money in circulation for the same year was

[1] *Government Insurance of Bank Deposits,* edited by Rollo L. Lyman, p. 40.

[2] *Chicago Banker,* July 4, 1908, p. 31.

only $34.72 per capita[1] the temerity of such a guess is evident.

These extravagant claims show one of the popular confusions as to the nature of a guaranty law. Money drawn out of hoarding and placed in banks would for the most part represent savings deposits, and primarily bank guaranty is not intended to protect such deposits. In none of the states do savings banks operate under the law. In Texas even the time certificates of deposit of the commercial banks are not protected. The original Kansas law protected savings deposits in commercial banks only to the amount of one hundred dollars to any one person. This restriction in the Kansas law was later eliminated, and now with the exception of Texas the savings deposits of commercial banks are protected in all the states.

It is nearly impossible to test the result of the laws at this point. There has been a tendency for the deposits of guaranteed banks to increase, but there is no way of telling whence these deposits have come. It is known that they have come in part from the national banks and from all indications this deflection goes a long way in explaining the gain made by the state banks. Undoubtedly there have been eccentric individuals who have been induced to place their money in banks, but there is no evidence that the total deposits of the state have been greatly increased by drawing into circulation the supposedly large sums that are hidden away. This would seem to indicate that the amount of money in hoarding has been greatly exaggerated.

This completes the review of the more important arguments that were used a dozen years ago for and against the guaranty principle. It is evident that the claims on both sides were much exaggerated. The principal cause of this exaggeration seems to have been that it was not generally recognized that the matter was one of insurance and noth-

[1] *Report of the Comptroller of the Currency*, 1915, vol. II, p. 37.

ing else. The general public was vaguely talking of the "guaranty" of bank deposits; to many there seemed to be something about it that resembled insurance, and in the minds of a few the idea was lurking that it was insurance; but for the most part the conception of the fundamental basis of the proposal was at first very indefinite. It is well known that insurance exists primarily not to eliminate loss, but rather to indemnify and to scatter the burden of the loss after it occurs. If the proponents of bank guaranty had understood more fully the province of insurance in the modern world they probably would have escaped the error of thinking that bank-deposit insurance would cure all the ills of our banking system as it existed in 1907. On the other hand, the opponents of the movement might have saved themselves in the same way. When modern governments turned their attention to the subject of social insurance they had not only few statistics as to the risks involved, but their control of the risk was also seriously limited. Yet even in the face of these obstacles social insurance has at least demonstrated its feasibility. In marked contrast to this, modern states have elaborate statistics of bank losses from which to construct a mortality table, so to speak, and through their power of bank supervision almost complete control over the risk involved. The relative simplicity of the insurance problems involved has made the administration of the laws much easier and much less harmful than many predicted. The whole movement reveals a striking example of the tendency of the American people to overemphasize the influence which legislation can have upon economic conditions.

CHAPTER IX

CONCLUSION

This essay opened with a consideration of bank credit and the rôle it plays in the economic life of modern countries. The attempt was made to show that bank credit is an elemental thing which manifests itself in two forms, namely, bank notes and bank deposits. In the past note credit has been more widely employed, because it was issued in a form that could be easily carried about and used in making payments. Because note credit has been more important historically, and because of the form in which it is issued and the nature of its circulation, the legislator has long been impressed with the necessity of giving it adequate security. But in the last fifty years the railroad, the telegraph, and the telephone have revolutionized communication and brought people closer together. This changed condition powerfully affected banking practices, for the public gradually came to find that deposit credit was better adapted to the new situation. This change has been most marked in English-speaking countries, until now in this country the magnitude of deposit credit ranges all the way from fifteen to twenty times that of note credit, and the deposits subject to check transact about ninety-two per cent of the business of the country. By taking this larger view of the field of bank credit, it is much easier to see where bank-deposit insurance fits into a general system of banking regulation.

This remarkable change which has occurred in the realm of banking has shifted the safety of the business community largely from the shoulders of bank notes to those of deposits. The situation in this country is peculiar for two reasons. In the first place, with the exception of England, deposit banking has assumed larger proportions in this country than in any other; and, in the second place, our

adherence to the democratic principle of free banking has decentralized banking responsibility. When one of the isolated units of our banking system fails, the public is often a heavy loser. Under a monopolistic, centralized banking system the responsibility is concentrated in a few hands and each bank, instead of being an isolated unit, is usually a branch of a larger institution. This concentration of banking power and banking responsibility, coupled with the relatively less use made of deposit credit, gives the depositor a security quite lacking in this country. These peculiarities of the American banking situation explain why state interference in behalf of the depositor has gone farther in this country than in any other. The guaranty laws are the latest and most radical form of this state activity.

This essay has attempted to give an account of this banking experiment. Throughout the story there runs one warning, beside which all others sink into insignificance. Insurance cannot be abused with impunity. Honest insurance has proved a great blessing to mankind, but it is likewise true that corrupt and dishonest insurance may equally exploit the public. There is no magic about government insurance. If the state is to administer successfully a bank-deposit insurance company it must be willing to pay the same price that is now being paid by the best private insurance companies. This is the great consideration and before it all other things must bow.

Before quitting the subject two other considerations deserve attention. One of the striking results of the laws is the deep root which they have taken in the public mind. The underlying principles of the laws have such a hold on the public that it seems incredible that any of the laws could be uprooted. A great change has come over the bankers themselves. The state bankers realize that the laws are with them to stay and that the best policy is to support them enthusiastically. The national bankers,

realizing that the laws have disturbed their business much less than they anticipated, have lost much of the bitterness that characterized their attitude years ago.

Finally, it seems quite clear that the movement as a propaganda is dead. Undoubtedly from time to time other states will adopt such laws, but the movement can never take the form it did in 1907 and 1908. At that time the proposal had not been subjected to critical analysis with the result that too many extravagant claims were made for it. Since then the whole subject has been enriched with a wealth of experience, and the states that enact such laws in the future will do so with much fuller knowledge of what may be accomplished.

It may confidently be expected that in the years to come deposit credit will assume even a greater relative importance in the economic life of this country. The growing density of population and the more extensive use being made of all kinds of rapid communication point in this direction. There is little difference of opinion as to the desirability of giving this credit security and stability; people differ only as to the methods to be employed to attain this end. The problem is much more difficult than that of note security, for deposit credit has been pyramided to such a height that the individual bank, working alone, cannot protect this top-heavy structure by the segregation of special assets as is usually done in the case of note-credit. Consequently, in this age of insurance the principles of insurance have been extended to this field of human risk. Twelve years have passed since the first law was enacted and in the meantime the experiment has been transferred to other states and is now being worked out under divers conditions. Since the welfare of all is intimately connected with the end in view, this experiment is worthy of the most dispassionate observation and study.

THE END

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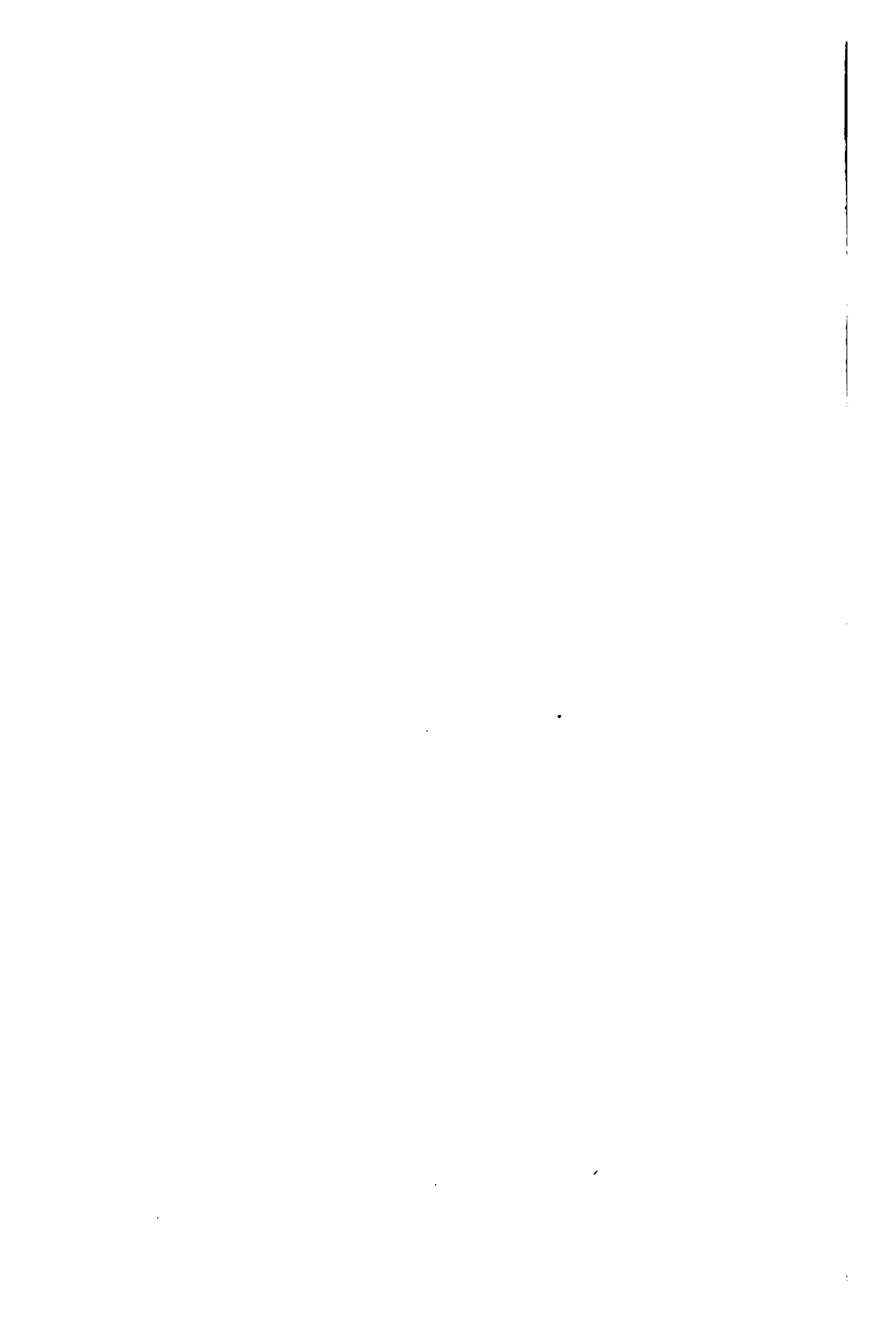

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The material for the study of the guaranty of bank deposits may for convenience be divided into three general classes. In the first place, there is a great mass of material which the heated discussion in the early stages of the movement called forth. This material is in the form of contributed articles, editorials, and reported speeches of bankers and others in which the subject is discussed both *pro* and *con*. This material is of little help in studying the subsequent history of the movement, but it is of inestimable value in showing the ideas uppermost in the minds of people as they approached the subject for the first time. Besides the magazine articles listed below the best sources of this material are in such financial publications as the *Chicago Banker*, the *Commercial and Financial Chronicle*, the *Bankers' Magazine*, *Bradstreet's*, etc. There is also a great deal of the same kind of material to be found in the *Proceedings* of the American Bankers' Association and of the State Bankers' Associations in the various states.

The second source of material is found in such articles as those of Thornton Cooke, Z. C. Dickinson, and V. E. Danner. These articles have been written since the laws became effective and give much valuable data regarding the different laws in operation. Of these articles the ones by Thornton Cooke in the *Quarterly Journal of Economics* are the most helpful, not only because of the study he has given to the laws, but also because of his unbiased and scientific approach to the subject. The articles by Z. C. Dickinson are confined to Nebraska, and give the best presentation of the historical background of the law in that state. V. E. Danner has confined himself largely to Oklahoma. He is an ardent supporter of the guaranty idea, and presents a strong case for that side of the question.

Finally, the last general source of information is actual field work. Only in this way can indispensable data be secured and the manifest temper of the people be understood. This kind of work is especially important in Oklahoma. When the Oklahoma law was passed the state government was not well established. In the meantime the state capital had been removed from Guthrie to Oklahoma City, and, pending the construction of a capitol building, the different state departments were housed in various office

buildings of the city. In this confusion most of the early records of the administration of the law seem to have been lost. In addition to this the present state banking department has little sympathy with the early administration of the law and knows practically nothing of what was then done. For these reasons much of the early history of the Oklahoma law can be secured only through personal interviews with the men who were in touch with affairs at that time. Finally, the operation of the Oklahoma law is inseparably connected with the remarkable economic development of the state, and some of the aspects of this situation can be fully understood only after close contact with the people who have lived through that period of the state's development.

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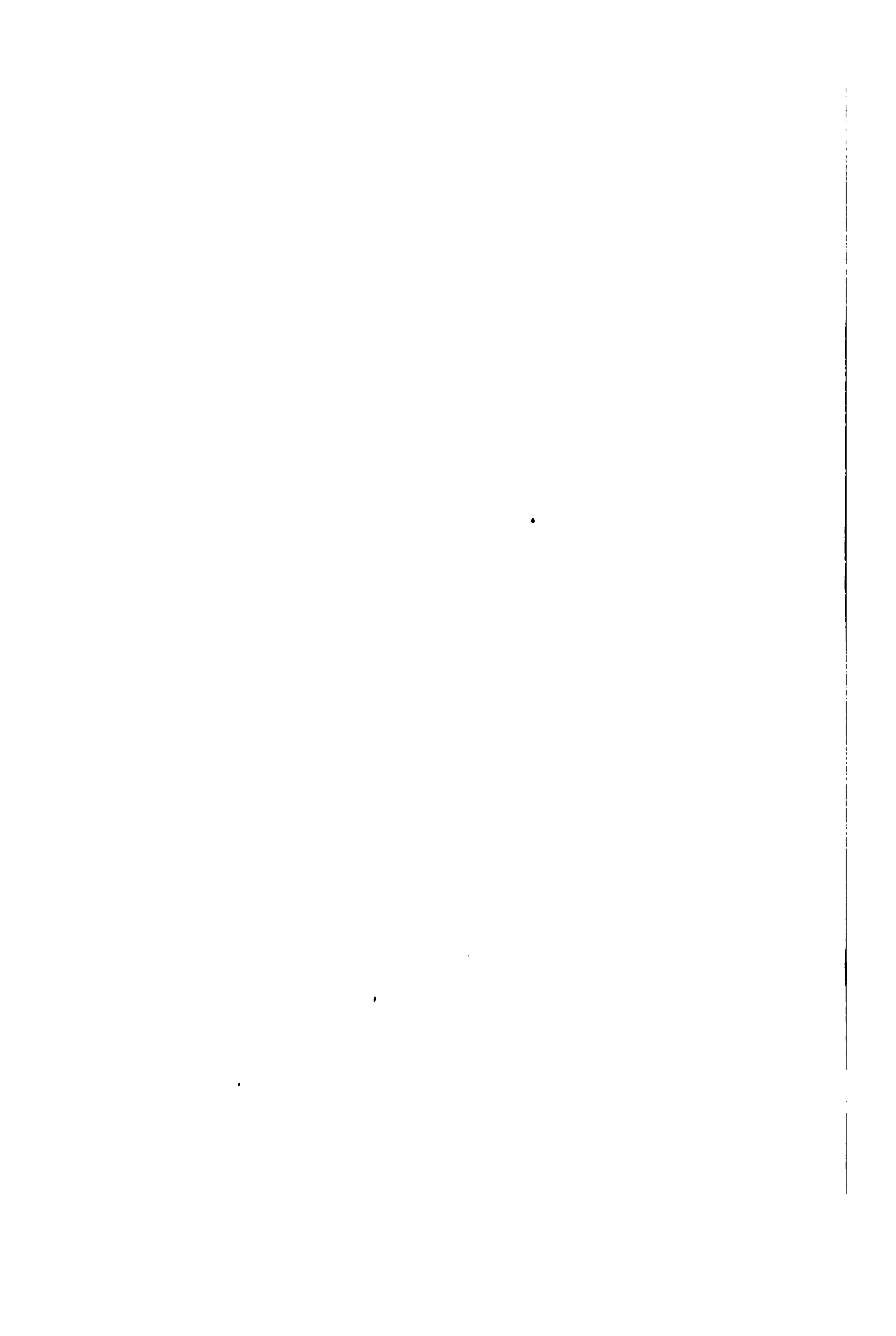

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